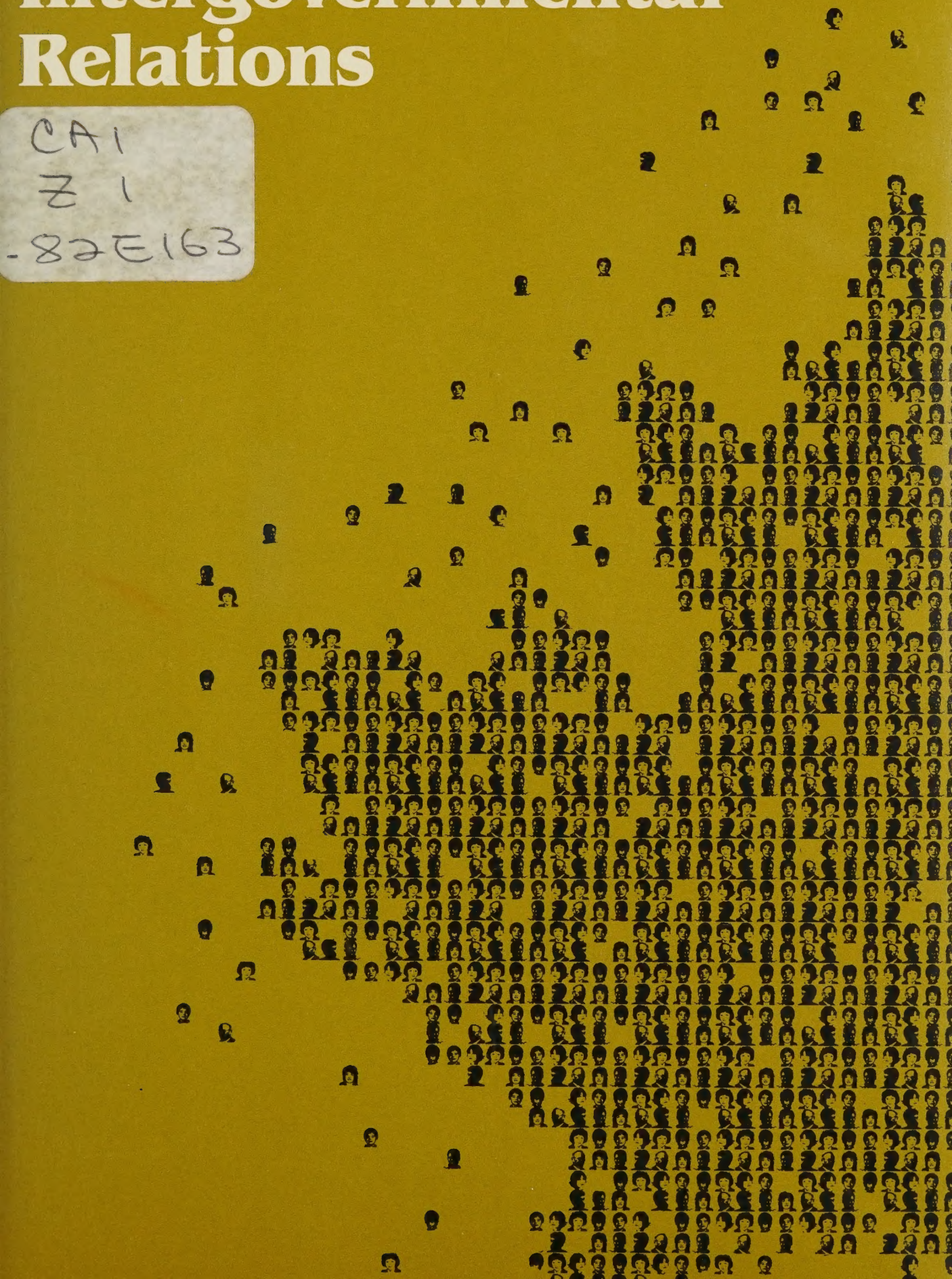
RICHARD SIMEON, Research Coordinator

Intergovernmental Relations



Intergovernmental Relations

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RICHARD SIMEON
Research Coordinator

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CONTENTS

When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's Research Program was carried out under the joint direction of three prominent and highly respected Canadian scholars: Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September, 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD

At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (over 280 separate studies in 72 volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, *Law and Constitutional Issues*, under Ivan Bernier, *Politics and Institutions of Government* under Alan Cairns, and *Economics* under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*
- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multicultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

Economics research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, how institutions and policies affect this allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald, the Commission's Executive Director, Gerald Godsoe, and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants, Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

Ivan Bernier
Alan Cairns
David C. Smith

One of the defining features of contemporary federalism is the interdependence among governments; today, few watertight compartments remain. The effective management of a maze of intergovernmental contacts has become essential not only to meeting the policy challenges that we face, but also to the reconciliation of national and regional interests and to the strengthening of responsive, democratic government. The studies in this volume not only explain why these relationships have become so important, but examine why they have posed increasing dilemmas for Canadian democracy and Canadian policy making.

In his study, J. Stefan Dupré assesses the workability of the Canadian pattern of executive federalism. Changes in the process are directly related to wider change in the roles and aspirations of governments, and to changes in the structure and dynamics of policy making that have taken place within governments. The postwar pattern of cooperation among bureaucrats has been replaced by a more political process as well as a decline in the strength of networks of "trust relationships." Dupré explores several alternative models for conducting intergovernmental relations, and he suggests that we must shift from the constitutional model to more functional relationships.

James A. Brander examines the structure of incentives that operate for the participants in the intergovernmental "game." How is it possible to shift incentives so as to reduce the temptation for non-cooperation and for beggar-thy-neighbour actions? What is the rational basis for intergovernmental cooperation?

Study of intergovernmental relations has tended to focus on conferences involving all 11 senior governments, and in his study Kenneth McRoberts powerfully reminds us of the wide variety of intergovernmental relations outside these formal forums. McRoberts explores three models, focussing

on unilateral activities by one government in areas of concern to the others; on highly varied bilateral relationships between Ottawa and individual provinces; and on relationships that are truly multilateral. He suggests that this variety of approaches is well suited to the diverse character of Canadian provinces. In particular, such relations have allowed sufficient flexibility to accommodate much of Quebec's distinctiveness.

As they look at the consequences of the growth of public enterprise, K.J. Huffman, J.W. Langford and W.A.W. Neilson also remind us of the variety and flexibility of mechanisms of intergovernmental relations. The authors observe that, on the one hand, public ownership can complicate federalism — it provides governments with a tool with which to act in areas outside their jurisdiction. On the other hand, the authors suggest, there is considerable potential in the use of jointly owned federal-provincial Crown corporations to achieve common purposes not now easily reached.

Another relatively neglected field is the study of relationships between provincial governments and municipalities. While they have no independent constitutional status, municipalities have emerged as vital components of Canadian government. Two papers address different aspects of these linkages. In their study, Harry M. Kitchen and Melville L. McMillan provide a broad survey, concentrating on the fiscal relationships between the two orders. They also study avenues of reform regarding powers and fiscal responsibilities that might be given to the municipalities, and they discuss whether such changes should be implemented. Jacques L'Heureux focusses his study upon the constitutional dimension of the subject. The authors of both papers find that the role and responsibilities of municipalities are tightly constrained by their fiscal and constitutional dependence on the senior orders of government, and they examine alternative ways in which municipalities might achieve greater autonomy and influence.

An inevitable consequence of the interdependence among governments is a massive expansion in the range of intergovernmental relations. Writing from a variety of perspectives — political science, economics, law — the authors of the six studies provide a thoughtful discussion of the process and its effects.

RICHARD SIMEON

ACKNOWLEDGMENTS

The Commission's consideration of intergovernmental relations and the research presented in this volume were both greatly assisted by a small group of senior former practitioners convened by Professor J. Stefan Dupré. Their experience helped guide us through the labyrinth of intergovernmental relations.

R.S.

1

Reflections on the Workability of Executive Federalism

J. Stefan Dupré

In recent years, interaction among federal and provincial first ministers has fallen into a state of disarray. At the level of ministers and officials, federal-provincial relations have become so varied and complex that they defy generalization. As a long-time national sport, executive federalism, like the post-expansion NHL, has become the subject of anxious hand-wringing by many of its practitioners and much of its audience. This essay, written by one of the latter, but enriched by the insights of a small number of experienced practitioners,[1] probes the workability of executive federalism. By workability, I do not mean the capacity of executive federalism, on any given issue or at any given time, to produce federal-provincial accord as opposed to discord. Because executive federalism is rooted in what Richard Simeon has labelled succinctly the "political independence" and the "policy interdependence"[2] of our federal and provincial governments, it is these governments that make the fundamental choices to agree or disagree. Whether executive federalism works involves not whether governments agree or disagree, but whether it provides a forum (or more accurately a set of forums) that is conducive, and perceived to be conducive, as the case may be, to negotiation, consultation or simply an exchange of information.

A major theme of this essay is that the workability of executive federalism is to an important degree a function of the manner in which the executives of our federal and provincial governments operate. This is explored in an introductory way under the heading Executive Federalism and Intragovernmental Relations, and probed further in the next two sections, one entitled Federal-Provincial Functional Relations, the other Federal-Provincial Summit Relations. These sections probe selective circumstances under which executive federalism has been a more-or-less workable mechanism of federal-provincial adjustment. The final section

of this essay, titled Prescriptions for Workable Executive Federalism, proposes procedural and substantive directions that executive federalism might seek to follow for the balance of this century.

Executive Federalism and Intragovernmental Relations

The fundamental facts of Canadian constitutionalism are federalism and the cabinet-parliamentary form of government. The first means that the Canadian territorial division of power takes the form of two constitutionally ordained levels of government, each endowed with distinct yet often overlapping jurisdiction. The second means that executive and legislative institutions, through the constitutional conventions of responsible government, are fused in such a manner that what Thomas Hockin calls "the collective central energizing executive" (cabinet) is the "key engine of the state"[3] within each of the federal and provincial levels of government.

The Canadian version of the rise of the modern administrative state yields progressively larger and more potent federal and provincial bureaucracies, formally subordinated to their respective cabinets, and growing federal-provincial interdependence as each of these levels of government, driven by its energizing executive, actualizes the jurisdictional potential conferred upon it by the Constitution. With almost Sophoclean inevitability, the resulting need for a non-judicial mechanism of adjustment is met by what Donald Smiley so aptly calls executive federalism, "which may be defined as the relations between elected and appointed officials of the two orders of government in federal-provincial interactions. . . ."[4] Smiley includes relations among the elected and appointed officials of provincial governments under the umbrella of executive federalism, but this essay will refer to such purely interprovincial relations as "executive interprovincialism." This is in part to stress the fact that relations between governments that share identical jurisdiction are different from relations between governments that share divided jurisdiction, in part to acknowledge that executive interprovincialism has not infrequently been a provincial response to executive federalism.

"The relations between elected and appointed officials of the two levels of government" are taken as the constant that defines executive federalism. Executive federalism has been categorized in the literature from the standpoint of outcomes, as cooperative or conflictual federalism. From the standpoint of actors, it has been called summit federalism (relations among first ministers and/or their designated ministerial or bureaucratic entourage) and functional federalism (relations among ministers and/or their officials). From the standpoint of participating governments, it has been labelled multilateral (the federal and all ten provincial governments), multilateral-regional (the federal government and the governments of some, normally contiguous, provinces), and bilateral (the federal govern-

ment and a single province). These labels — and others — will be used where appropriate in the text of this essay; all, however, are deemed conceptually secondary to the notion of executive federalism as embodying the relations between the elected and appointed officials of the energizing executives of our federal and provincial levels of government.

It is this simple notion that permits me to observe that executive federalism, as a mechanism of federal-provincial adjustment, cannot be divorced from intragovernmental considerations, i.e., from the structure and functioning of the "collective central energizing executives" with which the conventions of the Constitution endow Ottawa and each of the provinces. Without altering one iota of the constitutional conventions that give them their central energizing force, cabinets can operate in vastly different ways. Thus, for example, at any given point in time, there will be differences in the manner in which cabinets operate in Ottawa, as distinct from large provinces, and as distinct from small provinces. Such differences, which may be accentuated by the role of political, especially prime ministerial, personalities and by the complexion of different governing parties, will be acknowledged as this essay proceeds. More important to a general consideration of executive federalism are historically distinguishable modes of cabinet operation. I shall distinguish three such modes of cabinet operation. The first, which I choose to label the "traditional" mode, is one in which cabinets can be said to operate primarily as what Jean Hamelin calls "chamber(s) of political compensation."[5] This mode of cabinet operation antedates the rise of the modern administrative state and, for that matter, of executive federalism. Here, cabinet ministers, given the limited scope of their respective governments, preeminently articulate and aggregate matters of regional or local political concern, and are primarily in the business of dispensing patronage. The extent to which the federal cabinet, in this mode of operation, can itself provide a mechanism of federal-provincial adjustment has been sketched aptly by Donald Smiley.[6] The second and third modes of cabinet operation, which respectively accompany the rise and then the maturation of the modern administrative state, are the ones that are material to executive federalism. I shall call the second the "departmentalized cabinet" and the third the "institutionalized cabinet."

The "departmentalized" cabinet at once reflects and abets the rise of the modern administrative state. Government departments, allocated among ministers as their respective portfolio responsibilities, are the prime depositories of public sector expansion and of the special expertise which fuels and responds to expansion. The functions assigned to a department make it the natural focus of discrete client interests, and the inputs of these departmentally oriented clientele groups interact synergistically with the "withinputs" of the department's expert bureaucrats. For ministers, this interaction breeds "portfolio loyalty" both because they perceive that their effectiveness is judged by their departmental clienteles and because they

depend on departmental expertise for policy formulation and implementation. Subject to greater or lesser degrees of prime ministerial direction, ministers are endowed with a substantial measure of decision-making automony which redounds to the benefit of their departmental clienteles and bureaucracies. In the departmentalized cabinet, a minister is of course always a member of what by constitutional design is a collectively responsible executive but, as James Gillies puts it so well, "the principle of Cabinet collective responsibility [is] based on the commonsense notion of confidence in one's colleagues, rather than on the concept of sharing of knowledge or decision-making."[7]

In the "institutionalized" cabinet, by contrast, various combinations of formal committee structures, established central agencies, and budgeting and management techniques combine to emphasize shared knowledge, collegial decision making, and the formulation of government-wide priorities and objectives. "The major thrust," Smiley writes, "is to decrease the relative autonomy of ministers and the departments working under their direction."[8] More than this, the institutionalized cabinet generates distinguishable categories of ministers; what Douglas Hartle calls the "central agency" ministers and the "special interest" ministers.[9] The portfolios of the former, in Hartle's words, "cut across special interest lines for they reflect the several dimensions of the *collective* concerns of the Cabinet."[10] Meantime, the ministers in the second category continue to pursue, "as they are expected to pursue, the special interest of special interest portfolios."[11] In this setting, intragovernmental decision making becomes not only collegial, but acquires a competitive, adversarial flavour.

The original Canadian home of the institutionalized cabinet is the Saskatchewan of Premier T.C. Douglas, and its best documented manifestations are those of the Pearson-Trudeau-Clark-Trudeau era in Ottawa. With substantial variations, both spatially and temporally, the institutionalized cabinet has as its theme the quest to make contemporary government decision making manageable. It arises initially as the response to the perceived defects of the departmentalized cabinet in the face of the range, complexity and interdependence of the decisions that contemporary governments are called upon to make. Once in place, it can be adjusted into a variety of configurations as the quest to make contemporary decision making manageable continues to be pursued with all the intensity of the quest for the Holy Grail. From one perspective, effectively articulated by Peter Aucoin, the institutionalized cabinet subjects special interests to the welcome challenge of greater scrutiny and increased competition.[12] From a contrary perspective, articulated with similar effectiveness by James Gillies, the institutionalized cabinet can so dissipate the input of special interests into the policies which affect them that it threatens to undermine the doctrine of government by consent.[13]

Which perspective is more nearly correct (and both may have enormous elements of validity) is less important for an essay on the workability of

executive federalism than the stark fact that the intergovernmental relations between elected and appointed officials of our two levels of government are bound to be affected by the very different intragovernmental relations that characterize the departmentalized and institutionalized modes of cabinet operation. To expound, let us consider federal-provincial functional relations and federal-provincial summit relations. In each instance, the transition from the departmentalized to the institutionalized cabinet has fundamental implications, as do the various configurations which institutionalized cabinets can acquire.

Federal-Provincial Functional Relations

From the 1920s into the 1960s, the Canadian story of income security, social services, health care, vocational education, transportation infrastructure, and resource development is a tale in which federal-provincial functional relations play a starring role. True to the operation at each level of government of the departmentalized cabinet, executive federalism rests upon relations between program officials, deputy ministers, and ministers from federal and provincial departments with overlapping or complementary missions. The relations are financially lubricated by numerous conditional grants which apply the federal spending power to individual programs that frequently, but not invariably, aspire to national standards. When categorized in terms of outcomes, federal-provincial relations are justifiably labelled as cooperative federalism.[14] The ingredients of these relations can be readily enumerated to yield what I choose to call the "functional relations model" of executive federalism. Each element in the model is remarkably conducive to the formation and maintenance of what Albert Breton and Ronald Wintrobe call "networks," that is to say, "trust relationships or trust ties,"[15] along intergovernmental lines.

- The appointed federal and provincial program officials involved in functional relations share common values and speak a similar vocabulary as a result of common training in a particular profession or discipline, e.g., Public Health, Social Work or Education.
- Departmentalized cabinets make it likely that the commonalities that characterize functional relations at the level of program officials will percolate to the deputy ministerial and ministerial levels. In the departmentalized setting, deputy ministers often will have risen through the ranks of their departments, thus sharing the outlooks of their program subordinates. As for ministers, the relatively uninhibited portfolio loyalties bred by the departmentalized cabinet induce a coincidence of views, notwithstanding their diverse political and professional backgrounds. Furthermore, the measure of decision-making autonomy which ministers enjoy as members of their departmentalized cabinets means that there is minimal likelihood that federal-provincial accord

at the ministerial level will be questioned or reversed by first ministers or cabinets.

- The trust relationships generated by the above two elements draw ongoing sustenance from the longevity of the federal-provincial structures within which functional relations are conducted. Enhancing as they do the likelihood of repeated transactions over long periods of time, these stable structures, to borrow the words of Breton and Wintrobe, "increase the future return to investments in trust."[16] They ensure that federal and provincial ministers, deputy ministers, and program officials, at any given point in time, have a stake in their future relationships.
- The financial lubricant supplied by conditional grants serves to aid and abet trust relationships in that the resulting program activity at the donating and recipient levels of government enhances bureaucratic careers and ministerial reputations. Such grants also insulate program activity from budgetary competition to the extent that they generate the familiar lock-in effect ("we are locked in by promises made to the provinces") at the federal level, and the equally familiar carrot effect ("50-cent dollars") at the provincial level.
- Special interests (e.g., those focussed upon public health, welfare or education) achieve virtual representation in the processes of executive federalism through the associational ties of department officials and the loyalty of ministers to their clientele-oriented portfolios.

If the four decades of federal-provincial functional relations, from which the above model is derived, can indeed be labelled an era of cooperative federalism, the evident exception is Quebec. But this exception supports rather than undermines the importance of the model's components. To the extent that Quebec officials shared professional backgrounds similar to those of their counterparts from Ottawa and the anglophone provinces, their distinctive academic formation was anything but tantamount to the common school ties (corresponding to the restricted number of professional faculties then found in English-speaking universities) worn by anglophone program officials. Moreover, in the Quebec version of the departmentalized cabinet, ministerial autonomy was severely circumscribed by the prime ministerial style of Maurice Duplessis and by the government-wide objective, founded on widely shared respect for classical as opposed to cooperative federalism, of protecting provincial jurisdiction and indigenous institutions. Again, in that Quebec did not uniformly exclude itself from functional arrangements, it is to be noted that the temporal longitude of federal-provincial structures, coupled with the open-ended availability of conditional grants, permitted selective shopping by the Quebec government and accommodated its acquiescence to programs of its choosing, normally in the domain of income maintenance. Finally, with respect to special interests, the extent to which Quebec's self-imposed exclusion from federal-provincial functional relations enjoyed societal support is testimony

to the segmentalist orientation,[17] driven by linguistic barriers, of this province's elites.

As the decade of the 1960s unfolded, federal-provincial functional relations underwent a significant metamorphosis. This metamorphosis parallelled and reflected the transition within governments from the departmentalized to the institutionalized cabinet. The budgetary distortions which conditional grants generated through their "lock-in" and "carrot" effects, once discovered by rationalized budgetary processes, spelled the demise of these grants on a grand scale. Equally consequential was the extent to which functional relations had to adapt to broader governmental considerations, acquired bilateral dimensions, and were forced to accommodate sudden shifts in personnel and structures. A few sketches, culled from the realms of social assistance, manpower training, and regional development are illustrative.

Social Assistance

The successful negotiation of the Canada Assistance Plan (CAP), in the period 1963–66, wrought the termination of several categorical conditional grant programs in favour of a broad shared-cost approach to income security and social services for persons in need. Rand Dyck's instructive account of the negotiations makes it abundantly clear that the long-standing relations among federal and provincial deputy ministers of welfare enveloped the emergence of CAP in a cooperative atmosphere.[18] However, Dyck notes that federal welfare officials, along with a number of their provincial counterparts, were oriented on professional grounds to favour a shared-cost design that would stimulate the achievement of high national standards. These views were overridden in favour of flexibility by federal central agencies sensitive to broader federal-provincial issues. (Dyck names the Department of Finance, Treasury Board, the Privy Council Office, and the Prime Minister's Office.[19]) The outcome was a CAP which relegated the matter of interprovincial discrepancies to the unconditional, fiscal capacity-related equalization payments of the *Fiscal Arrangements Act*, left welfare standards to the budgetary processes of provincial governments, and accommodated Quebec demands to the point where its opted-out position in the realm of social assistance became largely symbolic. What the CAP episode illustrates is:

- the continuing importance of long-standing trust ties among functional officials;
- a new central agency presence in federal-provincial functional relations; and
- the capacity of central agency influence to contribute to a harmonious federal-provincial outcome linked to considerations that lie beyond specialized professional norms.

The Social Security Review, launched in 1973, yields a different sketch of functional relations coloured by a different manifestation of the institutionalized cabinet. The origins of the Social Security Review lay partly in the Ottawa-Quebec jurisdictional discord (which eventually aborted the Victoria Charter in 1971), and partly in the capacity of policy analysis (epitomized by Quebec's landmark Castonguay-Nepveu report) to articulate the attractiveness of sweeping welfare reform, which, through a guaranteed annual income, would reconcile income maintenance with equitable work incentives for low-wage earners. The Review is distinctive because a significant number of its participants were by design individuals without social welfare backgrounds. This was visibly symbolized in the person of the then newly appointed federal deputy minister of welfare, A.W. Johnson, previously secretary of the Treasury Board (Johnson's minister, Marc Lalonde, had been principal secretary in the Prime Minister's Office prior to his entry into electoral politics); and it was tangibly manifest in the involvement, in both federal and provincial delegations, of economists and manpower officials, as well as of social welfare specialists. According to Johnson's account of the first two years of the Review, the diverse backgrounds of the participants eventually yielded a degree of mutual education. This was preceded, however, by time-consuming discord, bred by the extent to which "those concerned with employment and employment services were inclined to be suspicious of (social work) phrases like 'fullest functional potential' and the social workers tended to regard the manpower people as being excessively preoccupied with employment rather than the 'whole person'."[20]

Once federal-provincial functional relations are called upon not only to accommodate central agency influence, but to open their channels to individuals who articulate their positions from the standpoint of diverse professional backgrounds, there is reason to temper one's expectations of what they are capable of producing. And in the result, the failure of the Social Security Review to produce a guaranteed annual income invites the further consideration that, as it proceeded, this exercise unravelled an agenda item whose ramifications were simply too broad to be accommodated at any level of federal-provincial relations short of the summit. The government-wide concerns that can be injected into functional relations by central agency personnel do not obviate the competitive features of collegial decision making within the institutionalized cabinets of individual governments. Programs with an intimate bearing on the guaranteed annual income, like federal and provincial minimum wage laws, federal unemployment insurance, and provincial workers' compensation, are the preserve of agencies other than welfare departments. This being so, Keith Banting's verdict that the Social Security Review "was doomed from the outset by interdepartmental barriers at both levels"[21] has great weight. The institutionalized cabinet reduces departmental autonomy in a quest to make contemporary decision making manageable. However, pursuing

this quest in the framework of competitive collegiality and finding the Holy Grail remain two quite different things. The sources of the failure of the Social Security Review include interdepartmental tensions within each of the respective levels of government. And incidentally, to those who criticize executive federalism as an essentially closed process, Banting offers a telling rejoinder when he writes: "The politics of executive federalism focus the full glare of government and public attention on *intergovernmental* coordination failure. In comparison, *intragovernmental* failures languish in the twilight of cabinet discretion."[22]

This triggers a final observation with respect to the Social Security Review. Its one strong note of federal-provincial accord was sounded early in its existence, and produced a new source of asymmetric federalism: provincial configuration, i.e., provincial capacity to alter, within limits, the rates of benefits paid by the federal family allowance program. The point is that this achievement involved a program entirely within the portfolio of Health and Welfare Canada. A few years after the termination of the Review, the provincial gratification with which configuration had been received, particularly by Quebec, was undone by a unilateral federal measure — in the realm of taxation. Quebec had chosen a provincial configuration of family allowances that increased the rate of allowances with the rank of a child in the family. However, the Child Tax Credit, initiated in 1979, took no account of child ranking and was accordingly incongruent with Quebec social assistance benefits that had been integrated with the provincially configurated family allowances.[23] The resulting discord over federal unilateralism was quite as real as the fact that the source of federal unilateralism lay outside the welfare portfolio. In the circumstances, tax policy takes on the guise of an external event that impinged negatively on trust ties between federal and provincial welfare ministers.

Manpower Training

The design of the federal Adult Occupational Training Act of 1967 was in part the product of the major retreat from conditional grants sounded by summit federal-provincial fiscal concerns. It was also in part the outcome, at the highest level of federal economic policy making, of a unilateral decision to transform the vocational training of adults into an adjunct of employment policy.[24] Unveiled by Prime Minister Pearson at the federal-provincial summit conference of 1966, adult occupational training terminated almost 50 years of conditional grants in the realm of vocational education and assigned the use of training as an employment policy tool to the newly created Department of Manpower and Immigration. This initiative ended the functional relations long articulated by the vocational education divisions of provincial departments of Education and the Training Branch of the federal Department of Labour. The Branch's practice of recruiting its personnel from the ranks of provincial vocational

education specialists had ensured the prevalence, across divided jurisdiction, of shared professional norms. The Technical and Vocational Training Advisory Council, the structure within which federal-provincial trust ties had flourished during its 25 years of existence, was dissolved. Henceforth, through what was couched simultaneously as a constitutional claim and an effort to disentangle federal-provincial relations, the federal government would purchase, at full cost, training courses for adults, selected by its employment placement counsellors on the basis of these counsellors' assessments of their clients' aptitudes and future employment prospects. The desired training could be purchased either from public institutions under provincial control or from private sources.

That the federal manpower design of the mid-1960s never became reality is poignantly apparent from the fact, almost 20 years later, that this Commission listed as an unmet challenge the provision of "timely opportunities for retraining in order to enable working Canadians to adapt to changes resulting from technological innovation and competition."[25] The fate of the federal design was sealed within months of its unveiling by a provincial victory which stands as an early exhibit in the annals of competitive, as distinct from cooperative, federalism.[26] In brief, what happened was that provincial departments of education successfully interposed themselves between federal adult training and public postsecondary institutions, forced federal officials to deal with them as "exclusive brokers" of training courses, and used their exclusive brokerage to eliminate private-sector training programs as potential competitors. The ingredients of the provincial educationists' success included:

- support from the highest levels of their governments in a setting where the establishment of new postsecondary institutions (CAATs, CEGEPs, community colleges) enjoyed province-wide priority, and the task of orderly institutional development brooked no outside interference;
- their own close relations with college administrators who, in turn, possessed strong local and community ties; and
- federal inexperience with training programs and institutions, coupled with an incapacity to assess, let alone forecast, manpower needs.

Early on, the federal manpower initiative stimulated vigorous recourse to executive interprovincialism. It gave impetus to the formation of the Council of Ministers of Education in the summer of 1967, and to the initial prominence of the CME's Manpower Programs Committee as an interprovincial *cum* educationist counterstructure in the realm of adult training. As for federal-provincial relations, the federal design had been based on little by way of formal structure: the federal aim was to substitute buyer-seller relations for those of executive federalism. A multilateral body, known first as the Federal-Provincial Meeting of Officials on Occupational Training for Adults, and subsequently as the Canada Manpower Training Program (CMTP) committee, was intended originally simply to ease

exchange of information; but it immediately became a forum where federal and provincial officials divided themselves along professional lines, between federal economists bent on training as an adjunct of employment and provincial educationists wedded to the development of the "whole person." In short order, provincial insistence upon exclusive brokerage forced the formation, along increasingly structured lines, of bilateral federal-provincial committees. It was in these committees that the "purchase" and "sale" of training became a negotiated, shared-cost planning process subservient, most especially in the case of Ontario, to provincial institutional and enrolment strategies.

In that bilateralism is a fount of asymmetry in federal-provincial relations, it permits more or less cooperative or conflictual atmospheres to prevail in different provincial contexts. Significantly, it appears that the Ottawa-Quebec relationship in adult training proved at least a partial exception to otherwise conflictual relations at the functional level. In this instance, the provincial side of the bilateral relationship was articulated not by educationists, but by officials of the Quebec Department of Manpower and Immigration, whose professional backgrounds parallelled those of their federal counterparts. Recalling the times, a senior Quebec Manpower official noted that the conflict between economists and educationists, which elsewhere plagued federal-provincial functional relations, had instead emerged in Quebec as an intragovernmental conflict around the provincial cabinet table.[27] This invites the observation that cabinets are endowed with means of conflict resolution which federal-provincial bodies can never possess.

Regional Development

Thanks to the scholarship of Anthony Careless and Donald Savoie, there exists a relative wealth of information on the nexus between federal-provincial functional relations in the realm of regional development and the emergence of institutionalized cabinets at each of these levels of government. Careless concentrates on the years 1960–73 and traces regional development from its genesis in the ARDA of Diefenbaker and Hamilton, through the first era of the Department of Regional Economic Expansion (DREE).[28] Savoie, focussing exclusively on New Brunswick, takes up where Careless leaves off and sketches the course of regional development under what, in 1973, became a radically reorganized and deconcentrated DREE.[29] While a few paragraphs cannot do justice to the richness of the Careless and Savoie accounts, it is illuminating to highlight the essential thrust of what their works uncover.

ARDA (which stood initially for the *Agricultural Rehabilitation and Development Act* passed in 1961) was basically farm-oriented and spawned projects which "concentrated upon dealing with land and resources in order to improve the farmer's well-being."[30] Operated with the provinces

on a shared-cost basis, ARDA involved intergovernmental transactions conducted on a bilateral basis by the federal Department of Agriculture and its provincial counterparts along the lines of the traditional federal-provincial functional relations model.

The initial ARDA lasted only until 1964 when, with only the acronym retained, the Agricultural and Rural Development Act was legislated into being along with a special Fund for Rural Economic Development (FRED). As their names suggest, ARDA-FRED moved beyond farming to the much more encompassing realms of rural poverty and thus embraced a planned approach to regional development. ARDA-FRED was made the responsibility of a new federal department, Forestry and Rural Development, and launched a very different set of federal-provincial functional relations. These relations were to be articulated not by agriculture officials, but by planning specialists. And because the scope of ARDA-FRED was such that it embraced numerous provincial departments, it called for a government-wide planning capacity at the provincial level. Accordingly, the federal government under ARDA-FRED assisted especially the smaller and poorer Maritime Provinces in developing their own initial versions of the institutionalized cabinet. The resulting program agencies, planning secretariats or improvement corporations were linked to premiers' offices, cabinet committees, or both. The consequent provincial planning capacity was viewed by federal personnel as a positive step which they had helped to induce and signalled the emergence of new bilateral networks of like-minded federal and provincial officials.

As these networks formed, however, the institutionalization of the federal cabinet was unfolding apace. The advent of PPBS (Program Planning Budgeting System), with its emphasis on program objectives, and the 1966 reorganization that yielded a separate Treasury Board Secretariat and Department of Finance, each with its own minister, gradually impinged upon the Department of Forestry and Rural Development. The mission of Treasury Board officials focussed upon efficiency and effectiveness in the pursuit of defined objectives, while Finance acquired direct influence over the priority to be accorded to such objectives, notably in the striking "of a balance between economic proposals for maximizing 'welfare' (regional aid) and those for 'efficiency' (national productivity)."[31] Then came the new decision-making cabinet committees launched by Prime Minister Trudeau in 1968, and the enhanced role of the Privy Council Office as the manager of the committee system and the PCO's intolerance for "lack of effective interdepartmental relations in the federal government."[32] In the face of this configuration of events, structures and concerns, the Department of Forestry and Rural Development gave way, in 1969, to the new Department of Regional Economic Expansion.

Geared to the insistence that federal spending must effectively and visibly pursue federally designed objectives and federally determined priorities,

the Department of Regional Economic Expansion (DREE) shifted the focus of regional development away from rural poverty and toward industrial and urban growth, with emphasis on public works and jobs. At this juncture, the officials of the provincial planning agencies found at one and the same time that their Forestry and Rural Development network had disappeared and that their planning premises no longer coincided with those of Ottawa. As bilateral relations degenerated into an atmosphere of proposal and counter-proposal, it became increasingly clear that DREE's preferred style would be to by-pass provincial central agents altogether in favour of direct dealings with individual provincial departments. As a result, DREE succeeded in imposing this style to varying degrees in different provinces (indeed to the point where, in Nova Scotia, the provincial planning secretariat was dissolved). Lying behind DREE's success was not only the fiscal leverage of federal spending, but the impatience of provincial cabinet ministers with the planning agents of their own institutionalized cabinets.

Within a decade, regional development had moved from bilateral networks of federal and provincial agriculture officials to bilateral networks of planning officials to a setting in which a new centrally oriented federal department was penetrating provincial departments and writing off province-wide concerns. Then in 1973, the grounds shifted once again. In the wake of ministerial and deputy ministerial shuffles, and of the Liberal minority government produced by the 1972 election, DREE suddenly perceived itself as excessively insensitive to the provinces. It also discerned, through internal review, that regional development, whose focus had already shifted from farming to rural poverty, and thence to industrial and urban growth, should again acquire a new orientation. This time the orientation would be "the identification and pursuit of development opportunities."[33] The quest that this implied was to be shared with provincial governments and, to ensure on-site federal involvement, DREE was deconcentrated into provincial offices, each headed by a Director-General with substantial decision-making authority. Operating under the umbrella of a ministerial General Development Agreement with a ten-year lifespan, each provincially based DREE Director-General was designated the prime negotiator of subsidiary agreements with the provinces, these agreements being the "action pacts"[34] pursuant to which spatial or sectoral development projects would be undertaken.

Savoie's detailed study of federal-provincial relations under the Canada – New Brunswick General Development Agreement sketches an original portrait precisely because DREE's deconcentration was without parallel in Canadian administrative history. Launched on their shared quest to identify and pursue economic opportunities (whatever they might be), DREE's field personnel, headed by its Director General in Fredericton, and their provincial counterparts, headed by the Secretary of the New Brunswick Cabinet Committee on Economic Development, formed trust ties based

upon "being purpose- or result-oriented."[35] However, an alliance between federal field personnel, who are remote from Ottawa headquarters, and provincial officials, who are proximate to provincial politicians and senior bureaucrats, exposed a gap between slow decision making at the federal level and quick decision making at the provincial level. In addition to their proximity to the cabinet of a small province, provincial officials possessed "carrot effect" leverage from the shared-cost nature of development projects (in the New Brunswick case, a leverage which could be as high as 20-cent dollars). Faced with the consequent ease with which provincial decisions could be extracted, the federal government could only compromise its own decision-making apparatus. At DREE headquarters, officials often found their involvement "limited to reviewing subsidiary agreements and this only after the agreements [had] been fully developed and agreed upon by provincial DREE and provincial government officials."[36] As for the federal Treasury Board, it was left in a position where rejection or revision "would in fact not only be rejecting or revising a proposal from a federal department, but also one that [had] been approved by a province, in the case of New Brunswick, by the Cabinet."[37] Meantime, federal operating departments, on whose economic missions DREE–New Brunswick agreements impinged, found that they were not infrequently by-passed or compromised.

Early in 1982, the DREE of the General Development Agreements fell before one more federal attempt to make the decision making this department had circumvented manageable. DREE's reincarnation, merged with elements of the former Department of Industry, Trade and Commerce into the Department of Regional Industrial Expansion (DRIE), was accompanied by the deconcentration of a central agency called the Ministry of State for Economic and Regional Development (MSERD). This central agency, itself created a scant four years earlier to serve the conflict-ridden cabinet committee on economic development, was in turn slated for dissolution upon John Turner's accession to the office of prime minister in the summer of 1984. As for the General Development Agreements, they were allowed to die a natural death upon the expiration of their ten-year terms. Their replacement, named Economic and Regional Development Agreements, called upon the field officials of MSERD to play a key role (this role was made moot by the intended abolition of MSERD). About the only thing that could be said with certainty, as of mid-1984, was that the federal-provincial networks formed under the deconcentrated DREE had been destroyed.

Executive federalism, during the era of that deconcentrated DREE, displayed elements strongly reminiscent of the tradition-derived model of federal-provincial functional relations. Federal and provincial officials found common ground in the imperative to produce results out of their vague mandate to identify and pursue economic opportunities. The nine-year life of the bilateral structure, in which they articulated their relation-

ship, reinforced trust relations. The financial lubricant of cost sharing was copiously available. However, at least in the New Brunswick case, the provincial officials were central agents, not departmental personnel, and the federal DREE officials, given the wide scope of regional development, did not represent a department upon which clienteles with clear-cut functional interests focussed. The result was, particularly in the negotiation of sectoral subagreements (e.g., agriculture, forestry),[38] that the societal interests most directly affected had neither direct nor virtual representation. The capacity of DREE officials to circumvent the federal decision-making process, coupled with the carrot-effect leverage, which the provincial central agents could deploy vis-à-vis provincial departments, only reinforced this outcome. It appears that it was only when regional development projects were more spatial than sectoral that active consideration of affected societal interests entered into federal-provincial negotiation. In New Brunswick, these were the spatially defined interests of the Acadian northeast, with their partisan links to the Liberal cabinet in Ottawa, and of the anglophone southwest, with their partisan links to the Conservative cabinet in Fredericton.[39]

Federal-Provincial Summit Relations

Federal-provincial summit relations are epitomized in the media-haunted conferences of the 11 first ministers, but they have come to encompass also a variety of central agency ministers and officials. This being the case, they are strongly conditioned by the extent to which, within governments, the quest to make decision making manageable is eminently prime ministerial. In this regard, it is to be noted both that first ministers are the chief architects of their own institutionalized cabinets, and that they alone can elect to change or by-pass the decision-making structures and processes of these cabinets at any given time, and on any particular matter.

Federal-provincial summitry has fallen into a state of disarray. The starring role in how this came about must be assigned to the all-too-familiar conflicting forces that first ministers have so audibly articulated: Quebec nationalism/independentism, post-OPEC Western Canada assertiveness, Ontario's defence of its economic pre-eminence, Atlantic Province resentments, and federal counteroffensives to perceived excesses of provincialism. All these forces roosted at the federal-provincial summit table during the constitutional review exercise of 1980–81. Their continuing saliency, exacerbated by the fact that the outcome of the constitutional review was declared illegitimate by the Government and Legislature of Quebec, finds expression in the extent to which first ministers have become prone to talk past each other from their respective capitals, rather than with each other on the basis of their policy interdependence. It is tempting to conclude that federal-provincial summit relations, having fallen into such disarray, can be rescued, if at all, only by new political personalities

and governing parties with new orientations. After due reflection, I have personally succumbed to this temptation. My confession openly made, I shall probe summit relations, for the purpose of this section, principally in the context of their longest-standing agenda item, fiscal arrangements. The lengthy history of these particular relations enables us to discern how summitry can be workable; the present condition of these once workable relations aptly demonstrates the recent magnitude of summit disarray.

The taxing, spending and borrowing activities of government have always given a special status to Departments of Finance (or Treasury). Long before the rise of the institutionalized cabinet and the coining of the term "central agency," Finance Departments stood out as horizontal portfolios whose government-wide scope made them readily available adjuncts of first ministers. The war-conditioned initiation of tax rental agreements in 1940 gave to fiscal matters what turned out to be a regular quinquennial place on the agenda of federal-provincial summitry. By 1955, once the financial exigencies of recent and anticipated public-sector growth were apparent, the first ministers naturally turned to their finance officials in order to equip their fiscal conferences with an expert infrastructure. Thus was born the Continuing Committee on Fiscal and Economic Matters, to which was added a Tax Structure Committee of finance ministers in 1964 and then, beginning in the late 1960s, the still ongoing practice of pre-budget formulation meetings of ministers of finance.[40]

With these underpinnings, federal-provincial summit relations, through the devising of the 1977–82 Fiscal Arrangements, achieved results that are well known: divorce of tax collection agreements from intergovernmental transfers and tax sharing; orderly reallocations of income tax room between the federal government and the provinces; unconditional equalization payments geared to provincial fiscal capacity, as measured by a representative tax system; curtailment of conditional grants, and the development, initially, of a shared-cost and then, of a block-funding approach to health and postsecondary education; and accommodation of income tax reform through federal revenue guarantees to the provinces.[41] The path to these achievements was often acrimonious. Thus, for example, the 1967–72 Fiscal Arrangements, while they did not provoke united provincial opposition, were never endorsed by a summit meeting.[42] The 1977–82 Arrangements, which did receive summit endorsement in December 1976, previously had provoked a provincial common front.[43] What remains constant is that first ministers, whether or not they endorsed a particular set of Arrangements and however heated their periodic disagreements, had come to perceive their relations, underpinned as they were by finance ministers and officials, to be workable. The elements of this workability can be readily enumerated so as to comprise a "fiscal relations model" of federal-provincial summitry.

- Financial issues are inherently tangible and quantifiable. Accordingly, the parameters within which they are discussed can often be delimited within the bounds of common-sense bookkeeping (e.g., the question of tax room for the provinces is constrained by the fiscal capacity required to make federal equalization payments; and the extent to which provincial natural resource revenues can enter into an equalization formulation is confined by reference to what constitutes a tolerable growth rate in the size of the federal equalization bill). Also, the bounds of any particular issue can be narrowed and even resolved through easily measured saw-offs (e.g., the provincial common front, which formed in 1976 around a revenue guarantee termination payment of four personal income tax points, was bargained down to one point in tax room and one point in cash).[44]
- Finance officials share not only the common vocabulary of macroeconomic analysis, but also the common outlook (the "treasury mentality") bred by their roles as governmental fiscal managers. These characteristics, once situated under the umbrella of the long-lived Continuing Committee on Fiscal and Economic Matters, are conducive to the formulation of trust ties.
- Network formation among finance ministers is facilitated by the trust ties among their officials and abetted by their common preoccupations with revenue, and with managing the spending ambitions of their cabinet colleagues.
- From first ministers down to finance officials, the fixed maximum five-year term of fiscal arrangements means that any particular configuration of issues, however disputed, must once again be opened to review. This simultaneously eases the climate of consultation ("nothing is forever") and invites reinvestment in trust ties.

What happens to this "fiscal relations model?" Its effective operation remains abundantly apparent in the design of the 1977–82 Fiscal Arrangements and, most particularly, the Established Programs Financing (EPF) feature of these arrangements. The block funding of health and postsecondary education disentangled federal rates of spending from provincial rates of spending, and vice versa. As such, EPF contributed to the quest to make the spending of each order of government manageable. It is precisely what might be expected to emerge from an intergovernmental network of finance ministers and officials. The summit consensus of December 1976 testifies to the continuing influence of this network on first ministers, not least when two circumstances are recalled. First, the Parti Québécois had come to power in the autumn of 1976. Second, in the preceding summer, outright provincial rejection of Prime Minister Trudeau's minimalist constitutional patriation package had signalled the full awakening of western provincial

governments to constitutional issues and their consequent rejection of the Victoria amendment formula.

But December 1976 marked the last hurrah of the fiscal relations model. Its outline is barely discernible in the fashioning of the 1982–87 Fiscal Arrangements. From David Perry's account, it is apparent that negotiation among finance ministers and officials had little impact on any component of these arrangements other than equalization.[45] Here, the main result was a five-province representative average standard in lieu of the initial federal proposal for an Ontario average. For the rest, the fiscal relations model was inoperative. This is due in part to the weakening of the position of the Department of Finance within the federal government. It is more especially due to the fact (perhaps because of this weakness?) that the government of Canada chose to pursue its counter-offensive against provincialism beyond the constitutional review and into the fiscal domain.

By the mid-1970s in Ottawa, the institutionalization of the federal cabinet had attenuated the hegemony of Finance as the key horizontal portfolio in fiscal and economic management. Indeed, competition among central agencies, notably Finance, the Treasury Board Secretariat, and the Privy Council Office, was a documented reality.[46] The emergence, as the 1970s blended into the 1980s, of yet two more central agencies, the Ministry of State for Economic (later, Economic and Regional) Development and the Ministry of State for Social Development, engendered further competition for the Department of Finance in the decision-making processes of the Government of Canada. As Douglas Hartle asked pointedly in noting these developments, "Is it credible that Finance has as much impact on federal-provincial fiscal relations and on economic and social development policies as it had when it was the over-all 'economic manager' of the federal government?"[47]

The relative waning of the Department of Finance (and with it the fiscal relations model), in the devising of the 1982–87 Fiscal Arrangements, was signalled with the appointment of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements (the Breau Task Force) in 1981. This innovation could be viewed — and justified — as a positive step because it involved members of Parliament in the pre-legislative process and opened the fiscal arrangements to interest group involvement. But it also unleashed an Ottawa-centred view of the fiscal arrangements, in particular of its EPF (Established Programs Financing) component. The EPF block cash payment was perceived as lacking an acceptable basis in accountability to Parliament. Moreover, the Breau Task Force proved to be a federal magnet for interest groups dissatisfied with provincial spending and policies in health care and postsecondary education. It met, as Rod Dobell has noted, "the desire of provincially based interest groups operating in areas falling within provincial jurisdiction to appeal to the federal government for action [standards, criteria, rules, whatever] to offset

the impacts of provincial government spending [and legislative] priorities."[48]

At this juncture, it became apparent, at the highest political levels of the federal government, that the abandonment of block funding could be pursued in the name of parliamentary accountability and responsiveness to interest group demands — demands whose allure was enhanced in turn by polls demonstrating public antipathy toward user charges and extra billing by physicians for insured services. The upshot, after a stopgap extension of EPF for the first two years of the 1982–87 Fiscal Arrangements, was the Canada Health Act of 1984. And the potent appeal, especially in an election year, of the values of accountability and responsiveness, was dramatically underlined by the all-party support given to the passage of this act in the House of Commons.

A starkly unilateral federal initiative endorsed by the prime minister, the Canada Health Act emerged not from the Department of Finance, but from the collegial processes of cabinet decision making, served now not only by the Privy Council Office and its offshoot, the Federal-Provincial Relations Office, but by the Ministry of State for Social Development as well. In essence, the act lays down a code of provincial government conduct toward insured hospital and medical services. User charges and extra billing by physicians are deemed a violation of the code, and are henceforth subject to measured reductions in the EPF cash transfer to the offending provinces. Furthermore, compliance with the code requires a province to enter into a formal agreement with medical practitioners and dentists with respect to their compensation, and to the resolution of compensation disputes through conciliation or arbitration. Failure to comply entails reductions in the cash transfer, that are left for the federal cabinet to determine.[49]

These details starkly spell the demise of block funding, and with it the disentanglement of provincial from federal spending. Beyond spending, the very manner in which provinces choose to deal with health care practitioners becomes subject to federal fiscal intervention. What emerges is a fundamental reorientation of federal-provincial fiscal arrangements that has completely circumvented summit consultation and its underlying networks of finance officials and ministers. Thus does the disarray in federal-provincial summitry, exacerbated by the conflicting forces so apparent in the constitutional review, now embrace the fiscal arrangements that stood for decades as the staple agenda item of first ministers' conferences. One more point needs to be made.

The Canada Health Act fits the mould of federal counter-offensives to perceived excesses of provincialism. In this instance, however, the perceived excess at which the counter-offensive takes aim lies outside the mainstream of those which the Government of Canada sought to counter in the constitutional review. There, the perceived excesses converged

around matters of economic policy. The slogan "Securing the Canadian Economic Union" was the subtitle of the federal position paper on economic powers.[50] The economic union is to be secured from what are deemed to have been, for about a decade, balkanizing and unilateral provincial incursions into the economic realm, in the form of a wide variety of protectionist measures and province-centred industrial and resource development policies. The Canada Health Act, for its part, has nothing to do with countering such provincial economic incursions. It constitutes a federal counter-offensive to provincial policies in the social realm of health care, policies which are a mixture of fiscal, cost-control and professional compensation considerations. As such, the act is defensible in the name of accountability and responsiveness to interest group demands for equity. Meantime, however, the provincial incursions that have been perceived to affect the economic union are themselves defensible on the same grounds. Are not protectionism and province-centred development policies a reflection of provincial responsiveness to interest group demands, and of the ultimate accountability of provincial governments to their electorates? Viewed in this light, the condition that leaves the 11 ministers with their summit interaction in disarray is, if nothing else, deliciously ironic. And the irony will be compounded if postsecondary education comes to join health care as the subject of a code of provincial conduct, a matter under active internal consideration in Ottawa both before and after the 1984 election campaign.

The present condition of summit disarray casts a shadow over all manifestations of executive federalism. Nonetheless, I persist in holding the view, especially under favourable assumptions regarding personalities and governing parties, that this condition is not intractable. I insist, however, on stressing that the path to renewed workability, especially where interaction among the first ministers is concerned, does not lie in one more comprehensive attempt to "get the Constitution right." This is because I consider that any summit process called upon to devise the "right" Constitution is too likely to fail in the attempt, even allowing for sweeping changes in the dramatis personae of first ministers. When we include the 1968–71 route to the aborted Victoria Charter along with the 1980–81 exercise that yielded (only after Supreme Court assistance) the Constitution Act of 1982, it is apparent that multilateral summitry has failed twice to: achieve central institution reform; disentangle the division of jurisdiction; and recognize the historical mission of Quebec in the cultural domain. Setting aside whether or not these reforms were desirable in principle, I find a straightforward explanation for this double failure in what I call a "constitutional review model" of federal-provincial summitry. It is, in all respects, the diametrical opposite of my fiscal relations model.

- Constitutional issues, being symbolic and abstract rather than tangible and quantifiable, are not amenable to readily measurable trade-offs.
- The officials who underpin constitutional review deliberations include law officers who, to the extent that they view their respective governments as legal clients, may tend to magnify jurisdictional jealousies rather than reduce them on the basis of shared professional values.
- The horizontal portfolio ministers most closely involved are federal and provincial Ministers of Justice and Attorneys-General whose portfolios include recourse to adversarial processes before the courts, and who are therefore prone to examine constitutional proposals in this light.
- The whole process of a comprehensive constitutional review exercise focusses the attention of all participants, from first ministers down, on the "one last play" that will be the constitutional engineering feat of comprehensive change. The anticipated proximity of this last play depreciates investment in long-term trust.
- Because it is known that the "one last play" yields a quasi-permanent end result, given the rigidity of the amendment process, negotiations are inherently more tension ridden than when "nothing is forever."

My "constitutional review model" demonstrates all the reasons why the last thing I would prescribe for the current disarray in federal-provincial summitry is another comprehensive attempt at constitutional review. In the vocabulary of economics, the transaction costs are enormous, and the opportunity costs are likely to engulf all other matters that should occupy the summit agenda. I am mindful that these already include a constitutional item: the native rights that are mandatorily on the summit agenda by virtue of section 37 of the Constitution Act of 1982. Then there is the challenge of legitimating that very act in the eyes of the Government and National Assembly of Quebec.

The issue of native rights is confined rather than all-encompassing; it therefore offers the summit the opportunity to record an initial success in the use of our governmentally dominated amendment formula which might subsequently be emulated in other, similarly confined areas. As for the legitimation of the Constitution Act of 1982 in Quebec, I suggest that that likelihood is directly related to the extent to which it can be decoupled from any kind of comprehensive constitutional review. I suggest that the most salient points involve, in the first place, rewriting section 40 so that reasonable federal compensation would accompany provincial opting out of future amendments, beyond those restricted to educational and other cultural matters; and, secondly, acknowledging the existence of a Quebec veto. Both amendments are subject to the section 41(e) requirement of unanimity. In neither case do I see a multilateral summit of first ministers capable of playing a useful initiating role. I regard these as matters for

bilateral summitry between Ottawa and Quebec, accompanied by informal soundings of other first ministers in their capitals, but sustained on a bilateral basis to the point where agreed-upon texts would be ready for submission as government resolutions to Parliament and the Quebec National Assembly. Summit accord could then be sought for identical submissions to the other legislatures. Without such accord, the resolutions could be passed by Parliament and the National Assembly, leaving the nine English-speaking provinces the choice to ratify, within the three-year limit of section 39(2), what would finally legitimize the Constitution Act of 1982 *a mari usque ad mare*. If this scenario leaves me sounding like someone who recoils from burdening the agenda of summitry with constitutional matters, I stand guilty as charged. I look elsewhere than in the constitutional domain as I seek workable federal-provincial relations.

Prescriptions for Workable Executive Federalism

Having turned my back on the constitutional domain, where shall I look for workability in executive federalism? First, I will extract what I consider to be the moral of my stories of functional and summit relations, and on this basis formulate a number of propositions for first ministers in their roles as the heads of our "central energizing executives." I will then outline a prescription addressed to summit relations as such, one which has found favour with the experienced practitioners of executive federalism, who have given me the benefit of their insights. Finally, I will make a few observations concerning the potential of executive federalism in coming to grips with substantive economic and fiscal issues.

Two Tales of Executive Federalism

I have told a story of federal-provincial functional relations according to which there was a time, lasting until the mid-1960s, when these relations had sufficient commonality to be explained by a simple conceptual model. Thereafter, functional relations galloped off in several directions, as witnessed by examples which, though restricted in number, suffice to convey that wide variability in such relations has become a matter of fact. My tale of summit interaction, for its part, was about relations which, when fiscal arrangements were on the agenda, could be explained by another model, valid as late as the mid-1970s. These relations then bogged down in a state of disarray.

So much for my tales; what is their moral? When all is said and done, the moral of my stories is that the formation and maintenance of networks (i.e., trust ties) between the appointed officials of the two orders of government play a fundamental role in the workability of federal-provincial interaction. Trust ties can be a function of shared professional training and norms, as in the functional relations model; they can be a function of

geographical proximity and of shared desire to extract results from a vague mandate, as in the case of the deconcentrated DREE of 1973–82, and they can be a function of the shared vocabulary of macroeconomic analysis and a common interest in managing the spending ambitions of operating departments, as in the fiscal relations model.

Trust ties are communicable to ministers; even more so when ministers possess a measure of independent decision-making autonomy in their portfolios, instead of being oriented to collegial decision-making processes within their cabinets. Finance ministers are a special case. Presiding as they do over the original and historically most potent central agency, they are in a position to capitalize on the trust ties among their officials, to the extent that they have primacy of access to first ministers. Once this primacy is hedged by competing central agencies (especially by central agencies under other central agency ministers, who vie for their own access to their first ministers) finance ministers are in danger of becoming "central agency ministers like the others." The utility of finance officer networks thus will be dissipated.

The moral of my stories is simple enough. If it evokes a sense of nostalgia for the "good old days" of departmentalized cabinets, when operating department ministers enjoyed decision-making latitude and finance ministers presided over a horizontal portfolio unchallenged by insurgent central agencies, so be it. I happen to believe that future cabinet reorganizations, especially in Ottawa, can well afford a touch of nostalgia. I also believe, however, that in one form or another institutionalized cabinets are here to stay. The multiplicity, complexity, and interdependence of the decisions which contemporary governments are called upon to make demand both cabinet committees and central agencies. They ensure that the quest to make decision making manageable will remain ongoing and will lead to continuing experimentation with forms and processes, and this will extend beyond the executive and into legislative assemblies, if only because institutionalized cabinets, in attenuating the autonomy of "special interest" departments and ministers, generate a need for new channels of interest group consultation, new adjustments designed to accommodate the desideratum of government by consent. All of this has implications for the workability of executive federalism to which first ministers especially should be sensitive and which I choose to address by means of a handful of practical propositions.

- Central agencies per se are not inimical to the conduct of federal-provincial functional relations among ministers and officials. The case of the Canada Assistance Plan demonstrates that central agents can constructively inject government-wide concerns into functional relations. The key distinction to be observed is between occasional appearances to communicate or clarify general policy and ongoing participation in the process of consultation or negotiation. The latter is to be reserved for departmental ministers and officials.

- Once central agents (and for that matter officials from different departments with different professional backgrounds) enter a domain that has hitherto been the preserve of functional interaction among particular operating ministers and departments, as in the Social Security Review, then first ministers have reason to be concerned that the agenda item involved is too broad to be handled short of summit processes. Such an item is better placed before the first ministers themselves or before central agency ministers, who have been given a specific prime ministerial mandate to coordinate the departments involved with the item concerned (e.g., a guaranteed annual income).
- First ministers can virtually guarantee unworkable federal-provincial relations if, by design or inadvertence, the officials charged with articulating the positions of the two orders of government do so on the basis of the clashing norms of different professions. Manpower training is an excellent case in point. If professional norms clash and the matter cannot be confined to one professional group, intergovernmental consultation or negotiation by administrative generalists is to be preferred. Outstanding interprofessional differences are best left to fester or be resolved around each government's cabinet table. In line with this thought, I cannot resist the parenthetical insertion that I have long found incomprehensible the federal government's occasional plaintive request for an entrée into the Council of Ministers of Education. More than an interprovincial club, the CME is a club of professional educationists and fated to remain so for as long as primary and secondary education continue to dominate provincial education portfolios, which they will. Professional faculties of education stand in splendid isolation from the universities in which they are located. This fact speaks eloquently about containing one's expectations of what an educationist club could usefully contribute to manpower economics or scientific research and development.
- When the possibility of internal governmental reorganization appears on a first minister's agenda, he should actively consider its potential implications for workable federal-provincial relations. An internal reorganization that destroys an established federal-provincial network (e.g., the dismantling of the deconcentrated DREE in 1982), or that nips an incipient intergovernmental network in the bud (e.g., the replacement of the Department of Forestry and Rural Development by the centralized DREE of 1969), involves costs in foregone trust ties. These costs might have been avoided if the desiderata prompting the proposed change (visibility, closer adherence to Treasury Board guidelines, whatever) had first been communicated clearly to the federal-provincial networks as criteria to which their interactions should adapt. On the other hand, a reorganization might yield a new agency in order to enhance the internal priority that a government wishes to accord to a particular function. If that government's position in a particular federal-

provincial interaction is currently less than constructively articulated, consideration should be given to assigning that role to the new agency (e.g., the new Ontario Manpower Commission in the Ministry of Labour might logically assume the key role in federal-Ontario training relations).

- The institutionalization of cabinets means that departmental ministers and officials are less effective conduits for the claims of client interest groups than was once the case. By the same token, the capacity of special interests to achieve a degree of virtual representation in many forums of federal-provincial interaction has gone the way of the functional relations model. An enhanced use of parliamentary committees to ventilate group interests beckons on both counts. If recourse to such committees poses a particular problem in matters of federal-provincial interaction, this is because interest groups are not necessarily prone to follow the jurisdictional flag when the opportunity of open hearings presents itself. The more impressive problem that lurks behind parliamentary committees is asymmetry in group presentations. The Breau Task Force, implicated as it is in the current federal-provincial fiscal disarray, was a magnet for public spending coalitions; on the other hand its companion Task Force on Pension Reform, another inherently federal-provincial matter, attracted groups closely identified with the case for fiscal restraint.[51] First ministers should consider, and indeed might well consult on, the manner in which legislative committees examining matters of federal-provincial import could be equipped with terms of reference that attract the widest appropriate spectrum of contending views. So that parliamentarians might themselves have the opportunity to view federal-provincial relations writ large, rather than through the terms of any particular committee assignment, there might be merit as well in making an annual federal-provincial relations debate a set feature of each legislature's agenda, as with the Throne Speech and the Budget.

The above propositions can be considered as easily by first ministers in their respective capitals, as they can be at a summit conference. There is much to executive federalism below the formal interaction of first ministers themselves. My propositions are meant to sensitize the heads of our governments to what can be done with respect to federal-provincial interaction generally. What of their own interaction?

Toward Routinized Federal-Provincial Summitry

The good news about the recent disarray in federal-provincial summit relations is that the contending party leaders in the 1984 federal election campaign all promised to do something about it. While anyone who is familiar with the value of Canadian electoral promises has reason to call for the proverbial grain of salt, the prospect that this low-cost promise will be fulfilled by the landslide victor of the 1984 election is enhanced by the

honeymoon he has been accorded by his provincial counterparts. The accompanying fact that Prime Minister Mulroney is engaged in producing, at an apparently measured pace, his own version of the institutionalized cabinet, yields a situation that is brimming with potential. Given the recent disarray in federal-provincial summitry, I have been inspired by those experienced in the practice of executive federalism, to advance the view that the most portentous outcome of an early post-election summit would be agreement to hold annual first ministers' conferences as routine events each year. Such routinized conferences are as laden with potential as they are devoid of glamour. Their attractiveness lies precisely in being both.

Where being devoid of glamour is concerned, routine annual summits would not supplant any first ministers' meetings that must take place (e.g., on the constitutional matter of native rights), or that might take place on any momentous agenda item (e.g., fiscal arrangements). Their explicit purpose would be to make summit interaction a commonplace event. Their potential agenda would extend to any matters that already involve, or should involve, federal-provincial interaction at any level, from that of officials to that of first ministers. Their informal atmosphere would stress consultation and exchange, not negotiation. Emphasis on the fundamentally routine nature of the events would contain public and media expectations. It should involve an undertaking among first ministers that routine meetings do not include televised proceedings, or invite pre- or post-conference posturing by the participants.

As for the potential of routine annual summits, several considerations are worth highlighting.

- Because the matters that could appear on the agenda of routinized meetings potentially embrace anything of federal and provincial concern, preparation for each such meeting will necessitate close and ongoing interaction on the part of senior central agency officials situated in first ministers' offices or cabinet offices. The pressure on these officials to "show results" by extracting manageable annual agendas from their vague mandate should abet the formation of trust ties and promote workable proceedings.
- The nexus between federal-provincial interaction and intragovernmental organization, illustrated by the propositions I addressed to first ministers earlier in this essay, provides a practical if not invariably palatable menu for interchanges among the very individuals who, at the apex of their respective cabinets, share incentives to make manageable their own decision making, and the formal powers of organizing and reorganizing their governments.
- Regularly recurring events have the capacity to gather their own momentum and to evoke constructive patterns of behaviour. The latter range from mutual sensitivity, in areas where governmental actions

unavoidably overlap, to identifying opportunities for disentanglement, which might, in time, become the subject of individual constitutional amendments. Supremely, I dare to hope that routinized summitry would breed and nurture among first ministers what J.A. Corry calls "constitutional morality,"[52] a behaviour pattern that focusses on the norms, as distinct from the mere legalities, of federalism; a pattern that seeks simultaneously to capitalize on the socio-economic forces that bind a federation, and on those that demand decentralization.

Economic and Fiscal Issues

A prescription which calls for routinized summitry is one which focusses on a process that is incremental and that takes a long-run view of federalism. If it finds favour in the eyes of some experienced practitioners of federal-provincial diplomacy and selected political scientists, is this not because it is so congruent with the shared background and norms of what — let's face it — is just another professional group (if indeed the adjective "professional" is even applicable)? What about the urgency of economic issues in a Canada which, with its double-digit unemployment rate at the head of a long list of alarming symptoms, has its abundant share of the end-of-the-century problems besetting all advanced capitalist and social democratic systems?

Executive federalism must indeed come to grips with economic issues. It is hardly within my purview, and even less within my competence, to analyze the substance of these issues. Nonetheless, I do not hesitate to venture two sets of observations concerning the potential of executive federalism in coming to grips with substance. The first involves the importance of containing one's expectations of what might be called "multilateral economic summitry," and of searching out agenda items that hold at least some promise of early success. The second, whose relative urgency is easily measured by the fact that the next set of fiscal arrangements spans the years 1987–92, seeks to galvanize fiscal summitry into renewed and reoriented coherence.

I have several reasons to contain my own expectations of what multilateral summit relations can achieve with respect to economic issues writ large. For one thing, there is the track record of summitry with respect to the regionally most divisive economic issue in recent years: energy. Here, the intractable manner in which Premier William Davis of Ontario chose to present the position of energy consumers (not least during the Clark government interlude) guaranteed that summit negotiations must be confined to bilateral interaction between Ottawa and the producing provinces, rather than pursued on the agenda of the 11 first ministers.[53] For another, there is the elaborate exercise in multilateral economic summitry of 1978, complete with ministerial and other working groups. In Michael Jenkin's words, "The results of the conferences tended to be either agreements on

general principles that later turned out to hide very real differences, or agreements on isolated issues which did not, in themselves, add up to a coherent program of political action."[54] More generally, it is a fact that provincial premiers have been prone to use economic conferences as vehicles for charging the federal government with economic mismanagement, while the Government of Canada has perceived many provincial economic positions as an affront to its primacy in the economic realm. Once again, personality changes might rectify this situation, but it should be borne in mind that any summit conferences called in the near term to deal with "the economy" are bound to be major media events, replete with opportunities for political posturing. Such conferences, if they are to have any chance of meeting public expectations, will be in need of restricted agenda items, selected with an eye to their potential for eliciting consensus and demonstrating movement.

One possibility lies in regional development, now perhaps even more disoriented than after DREE's demise in 1982, because the Ministry of State for Economic and Regional Development has been dissolved. Federal-provincial interaction in regional development necessarily hinges in the main on bilateral relations, but a multilateral economic summit might well address in principle the future orientation of bilateral agreements. Michael Trebilcock, in a recent address to the Ontario Economic Council, suggestively raised the possibility that the thrust of future agreements might concentrate preferably on economic adjustment rather than development.[55] What he calls "General Adjustment Agreements" would focus upon adjustment costs arising from freer international trade and reduced barriers to internal trade.

Then there is the possibility of seeking summit approbation of Michael Jenkin's proposal for a continuing structure at the level of ministers and officials, which he calls the Canadian Council of Industry and Technology Ministers.[56] Bearing in mind that within governments (notably within the federal government) tensions among economic portfolios have been painfully apparent, I do not foresee that a CCIT has the same potential for trust ties as the long-standing Continuing Committee on Fiscal and Economic Matters. It beckons nonetheless, especially to screen what might or might not provide workable agenda items for future economic summits, and to assist in staffing the more informal, routinized summit meetings.

My own favourite, subject to a heavy discount for this very reason, is the possibility of economic summit deliberations on manpower training. What could be sought here is what is within the capacity of first ministers as heads of government to grant: federal-provincial interaction by ministers and officials concerned not with education, but with training as an employment placement and economic adjustment tool. The functional conflict, which reverberated some 20 years ago when the federal government attempted a serious initiative in this regard, arose in what I established

earlier in this essay was a context peculiar to the times. In the mid-1960s, employment and training for employment had not acquired the overtones of the moral and ethical imperative that they possess today. And now that non-university postsecondary institutions are firmly established and mature, they no longer justify provincial insulation from outside influence — be these called "federal," "economic," or "labour market" influences. If I discern a problem with placing manpower training on the agenda of an early economic summit, it is because this restricted agenda item may be swept up in the controversy of a Canada Health Act approach to post-secondary education. Having prescribed, in a suggestive vein, possibilities for workable economic summitry in the near term, I conclude by addressing what I consider to be the most pressing matter of substance for the processes of executive federalism: the fiscal arrangements for 1987–92.

The Canada Health Act, as I have already pointed out, leaves executive federalism in a position that is nothing if not deliciously ironic. Here is a federally devised code of provincial conduct, to be implemented through the application of the federal spending power, in the realm of social policy. This initiative came on the heels of a quite different federal thrust, one which, in the context of the constitutional review, sought to establish greater federal primacy in the realm of economic policy. Having largely failed in the latter, the Government of Canada successfully undermined provincial primacy in the realm of social policy. Here, surely, is Corry's principle of constitutional morality turned on its head. And it has its own economic downside. As Thomas Courchene observes:

> With health costs already representing over 30 percent of some provincial budgets and escalating rapidly, with the likelihood of even more cost increases arising from the combination of increasingly expensive diagnostic treatment and an aging population, and with a concerted effort by numerous health-related associations to be covered under the universal health plan, it would appear that increased innovation and experimentation is essential in order that more efficient ways of delivering health care can be found. Already much in the way of provincial experimentation is ongoing. . . . To the extent that the Canada Health Act serves to promote uniformity rather than flexibility and to favour conformity rather than innovation, it is clearly a move in the wrong direction.[57]

Putting Corry and Courchene together, the Canada Health Act is a *massive thrust* in the wrong direction. To be sure, it can be justified on grounds of accountability and responsiveness to interest group pressures. But so can any of a number of provincial interventions in the economic realm, including protectionist interventions, which generate costs that are not simply imposed on provincial electorates, but are externalized (i.e., borne elsewhere in the country). As Robert Prichard puts it so well, the externalities that flow from such interventions "are affected by a fundamental illegitimacy that does not apply, at least in theory, to federal intervention."[58] The parallel illegitimacy of the Canada Health Act is that health

costs are largely internalized within provinces and yet will be driven by a federal code. Thus a code applies where it has no basis in constitutional morality or economic rationality and is non-existent with respect to matters where it is warranted.

It is this precarious and anomalous situation which, in my view, cries out for rectification in the fiscal arrangements of 1987–92. The outcome that is earnestly to be desired is one in which a code of provincial conduct is withdrawn from the realm of social policy and applied instead in the realm of protectionist economic policies. The long-standing network of finance officials and ministers must be galvanized to probe once again the relative roles of tax sharing and fiscal transfers in matters of social expenditure. If the federal spending power is to be used to secure adherence to codes of provincial conduct, let this be examined in the realm of conduct that has perverse economic consequences, not where decentralized experiments in cost control are to be desired.

I fully appreciate that to transpose codes of conduct from social to economic policy will be a matter of the utmost political delicacy. The toothpaste, so to speak, is well out of the tube on two counts: any federal prime minister knows that the Canada Health Act enjoys significant support, and any provincial first minister knows equally well the forceful stake of special interests in provincial economic protectionism. What will be central is nothing more nor less than the extent to which first ministers, jointly and severally, can discern that grand abstraction, the public interest, as distinct from particular interests. The test I pose to executive federalism, from the level of finance officials to the summit, involves 1987–92 fiscal arrangements that will at least move in the direction of constitutional morality and economic rationality. The movement, as distinct from the outright resolution, is what is of supreme importance. Because in fiscal arrangements, as distinct from constitutional reform, "nothing is forever," the 1992–97 arrangements will present a further opportunity. What should be accomplished between now and 1987 is the movement, not without difficulty or even acrimony, as testimony to the reactivated workability of executive federalism.

Notes

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Economic Policy Formation in a Federal State: *A Game Theoretic Approach*

JAMES A. BRANDER

Background: Fiscal Federalism

In Canada, as in any federal state, there is continuing debate over the allocation of political authority among different levels of government. The objective of this study is to shed light on disagreements about the "division of power" between central, provincial and local governments by examining provincial policy making from a game theoretic point of view.

A federal state, like Canada, is a state with more than one substantive level of government. Not unnaturally there is a well-developed subfield in economics, known as "fiscal federalism," devoted to the analysis of public policy formation and financing in federal states. Before describing the game theoretic approach to analyzing policy I propose to review the insights and principles that emerge from the standard theory of fiscal federalism.[1] The central question of fiscal federalism can be expressed as follows. To which level of government should particular functions (such as education, defence, or monetary policy) be assigned? For each policy area there are some considerations that would support assignment to the central government and some that would support decentralization. The objective is to make some assessment concerning which considerations dominate in each case.

In assessing the likely performance of a particular policy one must start with two things: first, a criterion of performance (how do we know good outcomes when we see them) and second, an assumption about how governments behave. As for the criterion of performance, in this study I focus on economic efficiency.[2] A good outcome is one without waste and in which policies and economic transactions that would benefit those involved are actually undertaken. This study does not assume any particular income distribution objectives. The efficiency consequences,

especially through induced migration, of possible changes in the distribution of income are considered, and it is recognized that policies are formulated against a background in which equity considerations are important. This study will not, however, address issues such as whether centralized authority might be preferred because it redistributes income from one group to another.

Secondly, concerning the behaviour of governments, the standard assumption in fiscal federalism (and in public finance generally) is the "public interest" assumption. Governments are assumed to act in the interest of those they represent. A provincial government would pursue the objectives of provincial residents; the federal government would act in the interest of the Canadian population as a whole. An alternative assumption, the "private interest" view, is that government consists of individuals concerned principally with their own welfare. There are at least three separate themes arising from the private interest view of government, although all are embraced in the subject area referred to as public choice theory.[3]

One theme associated with private interest in government is the theory of bureaucracy as described by Niskanen (1971). Focussing on the bureaucracy rather than on elected officials, Niskanen argues that government bureaus can be expected to act much like monopoly firms selling services to the public. The difference is that payment is made by budget allocations raised from taxes rather than by direct charges. Niskanen suggests that, because government bureaus can request complete lump sum budgets, they are able to extract more surplus from consumer-taxpayers than even a monopoly firm could.

A second theme, associated with the term "rent-seeking," begins with the idea that any political unit consists of individuals who are indifferent between pursuing their own best interests through private economic activity and trying to influence government policy in their favour. Thus, for example, Canadian automobile manufacturers will devote resources to persuading the government of Canada to impose tariffs and quotas on foreign competition. Government policy is then seen as the outcome of competition for political influence.[4]

The third theme to identify is the theory of social choice and voting. The objective of this theory is to understand the consequences of voting (and other) procedures for making social decisions, particularly at the level of committees of political representatives.[5] One well-known problem associated with voting is "cycling": proposal A could be preferred to proposal B and B could be preferred to C, but C preferred to A. Another problem is possible exploitation of a minority by a majority.

In this study, with the exception of one section, I follow the public interest approach. As will be made clear later in the paper, the public interest assumption rules out certain possible inefficiencies of centralized decision making. Incorporating private interest views of government into

fiscal federalism may either strengthen or weaken, but certainly changes, the case for decentralization of many policy areas.

Taking efficiency as the criterion and assuming the public interest view of government motivation, a few extreme examples will bring out the main insights of fiscal federalism as they apply to the division of power between federal and provincial governments. As a first example, there seems to be a general consensus that monetary policy is best handled at the federal level: only the Bank of Canada should have the authority to print money and otherwise control the money supply (as is in fact the case). Oates (1972) suggests the following reason for this consensus: if any local or provincial government could create money, it could, just by using the printing press, create money with which to purchase real goods and services from neighbouring localities or provinces, creating a continuing incentive for inefficiently rapid monetary expansion.

The principle is that independent provincial monetary policy is inefficient because of "spillovers" or "external effects." The external effect is that if British Columbia prints a dollar and buys real resources from Quebec, then residents of Quebec would have fewer real resources and more dollars. Prices would be bid up, and on balance B.C. residents would end up with more than they had before the monetary expansion, and residents of Quebec (and the rest of Canada) with less. In effect, control of the money supply confers the ability to extract seigniorage from the rest of Canada through an inflation tax.[6]

The government of British Columbia, assumed to be concerned primarily with the welfare of B.C. residents, would have an incentive to use this power, ignoring the negative effects on residents of other provinces. All provincial governments would face this incentive, leading to a series of beggar-thy-neighbour monetary expansions. The point is that in policy areas where the external effects, or spillovers, are large compared to the internal effects, we can expect decentralized decision making to be inefficient. This inefficiency is analogous to the inefficiency caused by externalities in private markets. Carrying the analogy slightly further, we could say that centralized decision making corrects the inefficiency by internalizing the externalities.

This explanation of monetary policy spillovers is not quite complete. It assumes a fixed exchange rate between dollars printed in different provinces. In principle, there is no structural reason why B.C. dollars should not have a floating rate of exchange with respect to, for example, Quebec dollars. In general, the issue of which areas should be linked by a common currency or by fixed exchange rates is taken up in the study of optimum currency areas.[7]

The monetary policy example rests on negative external effects. Positive external effects also lead to inefficiency of decentralized authority. Perhaps the most obvious example is national defence. Any one province, left to finance its own defence policy would (presumably) not fully take into

account the external benefits to other provinces, insofar as one province's defence capability protects other provinces as well. At the international level NATO might be regarded as an attempt to internalize such external effects. Both positive external effects and negative external effects favour centralization.

One example of external effects that deserves special mention involves redistributional policies and induced migration. Consider two otherwise very similar communities, one which offered high levels of social assistance and high taxes and one which offered low levels of social assistance and low taxes. It seems reasonable to suppose that those who pay taxes would move to the community with low taxes while potential recipients of social services would be attracted to the community with high social service levels.[8] This effect would make it very difficult for any one community to offer high levels of social services.

The problem, as pointed out in Breton and Scott (1978, chap. 10), is that each community generates spillovers in its decisions about redistributional policies. Raising levels of social service and taxes confers external benefits on other communities because it attracts their poor and therefore frees their tax revenue for other types of expenditure. Lowering social service and tax levels has a negative spillover effect on other communities because it attracts their revenue sources and induces recipients of social services to move to these other communities. This argument does not rely on equity judgments concerning what levels of redistribution should be provided. It does, however, point out that decentralized decision making will, in this case, tend to result in a lower level of redistribution than would be agreed upon in the aggregate. Furthermore, any actual transport costs incurred as a result of migration are obvious sources of efficiency loss.

Most of the examples of external effects involve public goods (like national defence). The basic point is that inefficiencies arise from assigning authority for national public goods to provincial or local levels of government. On the other hand, public goods that are local in scope might reasonably be assigned to local authorities. So-called "common market" issues are also examples of external effects: if individual provinces could restrict the flow of goods or labour they would be imposing external costs on other provinces.

A second factor (in addition to external effects) favouring centralized policy authority is economies of scale. If some public services are most efficiently provided at very high levels of output relative to total demand for those services, then centralized authority might be called for.[9] Examples might include certain telecommunications services (like the CBC), certain police services (hence the RCMP), and possibly some large-scale research and development projects.

A third possible factor favouring centralized decision making concerns natural resources. It might, for example, be argued that natural resources in Canada belong, in principle, to all residents of Canada, and therefore

that the central government should have some authority over the distribution of natural resource rents. At the very least, some kind of centrally organized sharing of resource rents would ease the problem that economic activity might otherwise tend to migrate to resource rich provinces simply because individual economic agents are trying to get (directly or indirectly) a share of resource rents.[10] These, then, are the factors that would support centralized decision making: external effects, economies of scale, and possibly natural resource issues.

There are, on the other hand, several important factors that would lead to relative efficiency of decentralized policy authority, although these factors seem to be less well identified, analyzed, and documented in the literature. The first point to be made, however, as emphasized by Tresch (1981), is that if the central government has full information about tastes and technology, can process information easily, and tries to act in the public interest, then there is very little reason for decentralization. Any set of policies that would be decided upon by provincial governments could be duplicated by the central government. Any reasons for decentralization must, therefore, arise from some failure of the central government's ability to determine or implement efficient policy.

One important cause of such failure has to do with information problems. The preferences of private individuals concerning publicly provided goods are not known by the central government nor, for that matter, by any government. Furthermore, private citizens have well known incentives to misrepresent their preferences. If an individual believes that he (or she) is not to be taxed to pay for some service, then, provided he has any desire for the service at all, he has an incentive to greatly overstate the value of the service. If alternatively, taxes are to be linked to benefits, each citizen has an incentive to downplay the perceived benefits in an attempt to be a "free rider."

Decentralized government can, however, lead to at least partial revelation of preferences through a mechanism first described by Tiebout (1956). The basic idea is captured by the expression "voting with one's feet." Tiebout considered a setting in which a large variety of local governments provide local public goods. A consumer-migrant would shop among communities and move to that community whose mix of public services and taxes best satisfied his or her preferences. Tiebout argued that, provided the local public goods in question have no spillover effects, this "community shopping" by potential migrants would lead to efficiency in public goods provision, just as careful shopping for consumer goods leads to efficiency in a world of private goods. In effect, efficiency results from individuals revealing, via migration decisions, their preferences concerning public goods. Different communities end up offering different mixes of public services, but this is just a reflection of different preferences (and incomes) of consumers, and is what would be expected in an efficient arrangement.

The Tiebout argument does contain flaws and even the strongest proponents of the "community shopping" view would say only that "voting with one's feet" is a force in the direction of efficiency, and would admit that the Tiebout mechanism does have residual inefficiency associated with it. Even taken on its own simplified terms (i.e., without adding "complications" to the Tiebout model) the mechanism does not lead to complete efficiency because there are unavoidable externalities associated with each migrant's location decision.[11] This "market" for public goods fails to achieve efficiency.

At the level of provinces, of course, there is some doubt about whether the small community hypothesis maintained by Tiebout makes much sense in any case. To the extent that factors other than the tax–public service mix influence one's decision of where to live, the Tiebout mechanism becomes less significant. For example, many inhabitants of Quebec are strongly tied to the province for reasons having to do with language and culture. One would not expect such people to move to Alberta even if Alberta did offer a mix of local public services more suited to their tastes.

A second consideration favouring decentralization is similar in one respect to the Tiebout hypothesis: it is based on differences in preferences. The basic idea is as follows. There are well-known problems in trying to develop policy consensus when constituents have different preferences, even when these preferences are known to the government. The task of trying to construct policy choices from individual preferences is known as "preference aggregation" and is the central concern of social choice theory. The basic result (due initially to Arrow, 1951) is that there is no good way of aggregating heterogeneous preferences. If constituents could be divided into homogeneous subgroups, they could make more efficient social choices.[12]

The next step in the argument, which to my knowledge is unsupported by rigorous analysis, is that the more heterogeneous the preferences, the greater the inefficiency. If, therefore, residents of different provinces have systematically different preferences, efficiency gains will follow from allocating policy authority to provincial governments rather than to the federal government. One manifestation of the inefficiency of centralized authority in such circumstances is the sense of excessive standardization of government services.

A third argument for decentralization, and to me the most compelling, is similar to the argument for decentralization in the private sector. Specifically, even if preferences are known, the information gathering and processing requirements for centralized decision making may be so great as to render decision making hopelessly inefficient. Imagine, for example, the consequences of administering all garbage collection services from a central agency in Ottawa.

A fourth line of argument emphasizes the importance of closely tying expenditure decisions to real resource costs. If local residents decide upon public services and must also pay for them, they are likely to closely weigh the costs and benefits. If, on the other hand, funds come from the central government, beneficiaries of each particular public expenditure bear only a small portion of the costs and have incentives to push for excessive expansion of public services. Different interest groups even have an incentive to expend resources in lobbying to obtain a larger share of total expenditure, adding to waste. This argument does not hold under a pure public interest view of government motivation, but follows from a private interest or rent-seeking view.

Finally, as described by Oates (1972), Brennan and Buchanan (1980) and Breton (1983a, 1983b), efficiencies might result from competition between governments. Decentralization may result in greater experimentation and innovation in the production of public goods. Once one government finds a more efficient method of public goods provision, other governments might be induced by their constituents to follow. The originators of the improvement would benefit from being seen by voters to be providing good government, hence the incentive to innovate. Furthermore, if regional governments have the objective of gaining population (or losing it at a slower rate) via migration, and if successful mixes of services attract migration, then potential migration enhances competitive pressure.

A single central government would presumably have a much weaker incentive to improve efficiency through innovation, because there is little opportunity for comparisons to be made. Decentralization may therefore promote dynamic efficiency of this sort. Once again, this argument relies on government policy reflecting private motivations of government officials and therefore being susceptible to various forms of pressure.

These, then, are the insights from the received literature of fiscal federalism that bear on the degree of centralization of policy authority. Despite the familiarity of the arguments, many of them lack rigorous theoretical underpinnings and in addition, there is relatively little empirical work concerning the comparative importance of the different forces that have been identified.

One element that is left implicit but is common to all the arguments is that strategic interaction between different governments is important. Such interaction may promote efficiency, as in perfectly competitive markets, or inefficiency, as in imperfectly competitive markets. The theory of strategic interaction is referred to as game theory. In the next section, some of the basic terminology and insights of game theory are discussed, with a view toward analyzing the policy-making strategies of provinces. Some of the ideas presented so far lend themselves naturally to a game

theoretic treatment: indeed, most of the formal analysis of government policy implicitly or explicitly uses the Nash equilibrium as the equilibrium concept, as described in the next section. In addition, recent developments in game theory suggest new considerations that might be important for policy decentralization.

As mentioned, a general reference on fiscal federalism is Oates (1972). Useful collections of articles include Oates (1977) and Haveman and Margolis (1977). Good background on the Canadian environment includes an Economic Council of Canada study entitled *Financing Confederation* (1982), Boadway and Flatters (1982) and Walker (1978). As for sources on the theory and practice of government expenditure, standard public finance textbooks include Boadway (1979), Tresch (1981) and Musgrave and Musgrave (1976); see also Breton (1974) and Breton and Scott (1978). Some readings on the "rent-seeking" or private interest view of government are found in Buchanan, Tollison and Tullock (1980). Mueller (1979) gives a survey of the theory of public choice.

The Game Theoretic Structure of Provincial Policy Making

Game theory is the formal investigation of strategic situations. As the term "game" suggests, examples of strategic situations include parlour games such as bridge and chess, and many sports. These, however, are relatively minor examples; the more interesting applications of game theory arise from economic and political interaction. A (non-trivial) game has three essential characteristics: first, there must be more than one participant or "player"; second, the participants must have different objectives; and third, they must be interdependent in the sense that the action or strategy choice of one player affects the welfare of other players. Perhaps the most frequently studied application of game theory concerns imperfectly competitive markets. There are two or more firms and each firm cares about its own profit but is unconcerned about the profit of rivals, yet the profit of each firm depends not only on its own decisions but also on the decisions of other firms.

Provincial policy making also has a game-theoretic structure. Each provincial government has a particular set of objectives. As indicated in the first section, these objectives may, in accordance with the public interest view of government motivation, reflect the general interests of provincial residents, the private interests of elected officials and civil servants who make policy or, as is likely the case, some combination. At any rate, the main idea is that different provincial governments have different, sometimes conflicting, objectives. The federal government is also an important participant, with its own objectives, as are local governments. The policies one province undertakes certainly affect other provinces. Indeed, interdependence is just another term for the "spillovers" described in the

previous section. The difference in this respect between traditional fiscal federalism and game theory is that game theory focusses on interdependence as the central issue, rather than treating it as a distortion of some more fundamental structure.

Simply asserting that provincial policy making can be studied in a game theoretic framework does not then imply that clear predictions can be made about the outcome of provincial policy rivalries, for there is no single correct model of strategic interaction. What game theory provides is a language, a set of tools, and a set of insights that make it easier than it otherwise would be to move between basic assumptions and predictions about behaviour.

Game theory divides into two branches: cooperative and non-cooperative. Cooperative games are those in which players can sign binding agreements about their strategic choices before the strategies (or policies) are actually implemented. A non-cooperative game is one in which binding preplay agreements are not available: players may confer and may sign contracts, but they are allowed the freedom to break those contracts, and will do so, unless it is in their interest not to, as, for example, if there were severe legal sanctions associated with contract violation. Some analysts take the view that all strategic settings should be viewed fundamentally as non-cooperative games; cooperative game theory is then best regarded as a simplification or shortcut in which the punishments that induce players to honour agreements are left implicit instead of being made explicit, as they are in non-cooperative games.

The Prisoners' Dilemma: An Example

In this study, attention is restricted to non-cooperative games. Their basic structure is probably best introduced by example, and the standard introductory example is the so-called prisoners' dilemma. Imagine two bank robbers, P and J, apprehended after a robbery. The local Crown prosecutor separately makes each prisoner the following offer. If neither confesses, there is enough evidence to convict them on some minor charge with a penalty of two years each in prison. If P confesses and J does not, P gets a light sentence of one year, while J gets ten years. If J confesses while P does not, then the penalties are reversed. Finally, if both confess the penalties are seven years each.

What is the likely outcome of such a game? If P and J could make a binding agreement before the game is played, they might well agree not to confess, ending up with two years each. Binding agreements, however, are ruled out: neither prisoner can count on the other. Consider P's reasoning: "If J confesses, then I get seven years if I confess, but ten years if I don't. Confess would be a better strategy. On the other hand, if J does not confess, then I get one year if I confess and two years if I don't. Confess is still my best strategy." The strategy of confessing is referred

to as a dominant strategy in this case, because it is the best strategy no matter what the rival does. An identical prospect is faced by J. The solution confess-confess seems compelling. Yet it is is inefficient in the sense that it is much worse than the not confess-not confess solution. This inefficiency of non-cooperative games is one of the most important themes in game theory.

Usually, however, no dominant strategy exists. Consider a slight modification in the game. Suppose that, if neither P nor J confesses, both are freed. Now there is no dominant strategy for either player. What is best for J depends on what P does. If P confesses, J's best strategy is to confess; but if P does not confess, then J's best strategy is not to confess either. This interdependence of best strategies is also an important feature of many games.

Economic policy games are much more complicated than the prisoners' dilemma game, for there is usually a range of possible strategies rather than only two. The setting in this study is as follows. Each government is assumed to have an objective function and a set of policy variables. It is not entirely clear what the objective of a provincial government is or should be. As described in the first section, one problem is the difficulty in aggregating preferences of individuals; another problem is that it is not obvious whether a provincial government is concerned about current residents, future residents, or perhaps some subset of the resident population. In order to carry out the analysis, however, we simply posit a general objective function whose value depends on the policies chosen by various governments.

The policy variables themselves are easier to specify and would include tax rates, service levels, deficit finance levels, and so on. Associated with each set of policy variables is a strategy which can be quite complicated. It may specify an entire time path for policy variables, not just a single value to be maintained in perpetuity and, more significantly, it may include contingent policy moves like: "If my rival government charges a low tax rate, then so will I at my next opportunity, whereas, if he charges a high tax rate, then I will also charge a high tax rate in the following period."

Given the basic elements, including players, objectives, and policy strategies, one is in a position to apply the large body of literature in game theory to federal policy making. Not all game theoretic analysis is equally relevant or equally well established. What I propose to do here is focus on three elements of game theory that seem particularly relevant. The first concerns what would be meant by an equilibrium or solution to a game; the solution concept used is the "Nash equilibrium." The second is the idea of credibility or commitment: announced equilibrium strategies should be believable at all times that the player in question is called upon to take an action. The third concerns the relationship between cooperative and non-cooperative outcomes.

The Nash Equilibrium

First of all, the Nash equilibrium. The basic idea is that a Nash equilibrium arises when each player is choosing the strategy that is best for itself, taking as given those strategies chosen by other players. For example, if player A is choosing its best response to player B's strategy, and player B's strategy is simultaneously the best response to player A, then the pair of strategies is a Nash equilibrium in the two-player game. More formally, we represent the set of all possible strategies for player i by S^i, and we represent the objective or target of player i by T^i. Each player i chooses an element in i, denoted s^i, to try to reach the highest possible level of its objective. If there are n players we write:

$$T^i = T^i(s^1, s^2, \ldots, s^n).$$

The fact that T^i depends not on just s^i but on the strategies of the other players as well reflects the interdependence of the game structure. The strategy choices $s^* = (s^{1*}, s^{2*}, \ldots, s^{n*})$ constitute a Nash equilibrium if, for every player i, s^{i*} maximizes $T^i(s^{1*}, \ldots, s^{i-1*}, s^i, s^{i+1*}, \ldots, s^{n*})$, with respect to s^i. In other words, each player i takes the strategy s^j of each other player as fixed at its equilibrium level s^{j*}, and chooses its best strategy s^{i*}.

This solution concept for a non-cooperative game is due to Nash (1951) and is sometimes referred to as a "non-cooperative equilibrium" or simply as an "equilibrium point." Examples of Nash equilibria do, however, predate Nash, with the first known example formulated by Cournot (1838) and referred to as the "Cournot equilibrium." This is a Nash equilibrium for the case in which profit-maximizing firms are the players, and in which each firm must choose a single output level. The Nash equilibrium for this limited strategy set then embodies the idea that each firm takes as given the output of its rival, without considering possible reactions to changes in its own decision.

Another simple example of a Nash equilibrium is the "Bertrand equilibrium," which arises when profit-maximizing firms have as strategy sets possible prices they might charge. This equilibrium then includes the idea that each firm takes its rivals' prices as given. The Cournot and Bertrand equilibria are competing solution concepts that could apply to the same economic environment, but they would give different outcomes. Which is more appropriate in a particular situation depends on whether firms do in fact choose quantities and let prices vary to clear the market, or whether they set prices and allow output to be the residual variable. Harry Johnson (1953) examined optimal tariff arguments using a Nash equilibrium in tariff levels set by different countries. Also, as mentioned, the recent literature in public finance explicitly or implicitly uses the Nash

equilibrium. Examples include Buchanan and Goetz (1972) and Starrett (1980).

These examples of Nash equilibria all suffer from an apparent naivete attributed to players. It seems strange, for example, to assume that one firm treats its rivals' prices as fixed when it appears obvious that other firms may change their prices if this one firm changes its price. In these examples, the Nash equilibrium does not allow incorporation of reactions or retaliation as part of the thinking of firms. It should be recognized, however, that this lack of sophistication by players is not a general manifestation of the Nash equilibrium but a consequence of the simplicity of the strategy set.

If a firm's strategy set really consists of a single, once and for all, price choice, then there is no room for firms to think about retaliation. Each firm's manager can, before making the price choice, try to anticipate what its rivals might do and implicitly work out the Nash equilibrium in advance, but once its single equilibrium price choice is made, the game is over. When we criticize the apparent naivete of the firms, we are really saying that the strategy set is incomplete, that in fact firms should be allowed strategies like: I will charge price p now, then my price next month will depend on what my rivals do this month. Unfortunately, in order to render most problems tractable, it is necessary to work with simple strategy sets: strategy sets that are clearly incomplete. We can, however, make some progress beyond simple "one shot" games, like the Cournot and Bertrand games, and consider more complex strategies. First, an agent may have two or more strategy variables to choose, with some specific order. A firm may first choose its capital stock and later the associated output (as in Eaton and Lipsey, 1980, or Dixit, 1980) or may simply have to make repeated output choices for this year, next year, and so on.

In situations where they have more than one strategy variable and these strategies have a particular temporal structure, players implicitly make threats when they choose strategies. A firm's strategy may be something like: in period 1 capital stock x will be installed; in period 2 output will be chosen. A (possibly) different output would be associated with each possible different capital stock of the rival, y, because the rival's capital stock affects its ability to compete in the output market. The responses associated with different capital stock choices are threats. A simpler, but similar structure arises when governments choose tax rates in successive periods. A strategy might be: tax rate t will be chosen in period 1; if my rival chooses a low rate in period 1, then I will choose a low tax rate in period 2, whereas, if my rival chooses a high tax rate in period 1, then I will choose a high tax rate in period 2.

Strategies: Empty or Credible

In general, threats may be of two types: empty or credible. An empty threat is one that it is not in the player's interest to carry out when (and if) the

time comes to do so. A credible threat is one that the player does have an incentive to carry out. A generally accepted idea in game theory, first described informally by Schelling (1956), is that clearly empty threats should not be admissible. This is the second element from game theory that I focus on. Equilibrium strategies should be credible.

Consider the following game: your neighbour, whom you know quite well, knocks on your door one day and says, "Give me $100 or I will shoot myself." This is his announced strategy. You are reasonably well disposed toward your neighbour and would certainly part with $100 to save his life. If, therefore, you accept his announced strategy at face value, your strategy will be to give him $100. This Nash equilibrium consists of these two moves, and your neighbour is never called upon to carry out his threat. Suppose, however, that your neighbour would not really kill himself simply because you failed to give him $100; his threat is not credible, it is empty. As analysts, we might disallow the Nash equilibrium involving the incredible threat.

Restricting attention to credible threats is, like the Nash equilibrium itself, an idea that has emerged in several places. In macroeconomics the concept is referred to as "dynamic consistency" and in game theory it is referred to as "subgame perfection." The literature of industrial organization uses the terms "credibility constraint" and "commitment" to describe the idea. Credibility constraints restrict the set of possible Nash equilibria in a strategic setting. They also imply that agents may take prior actions precisely so as to commit themselves, or bind themselves, to carrying out threats they would not normally carry out, so as to gain strategic advantages. The best-known example of this involves firms building excess capacity so as to deter entry in a particular market.[13] As I shall argue in the next section, similar applications arise in studying government policy.

Note that issues of credibility do not rely on any uncertainty about the nature of one's rival. I know my rival and only actions that I know to be in his best interests are credible threats on his part. The next step, outside the scope of this study, is to add imperfect or incomplete information about rivals to the problem. In this situation each player may have an incentive to undertake certain actions to establish a reputation for being a certain kind of player. This is called "reputation-building."

Situations where establishing credibility or building reputations is important involve real economic costs. In the case of firms, excess capacity and premature investments (from the social point of view) are examples of such costs. Such phenomena will arise with government behaviour as well. One should be aware, however, that while resources devoted to establishing credibility or a reputation are wasted resources when compared to an ideal world run by a benevolent planner, it is possible that they are usefully allocated resources in the imperfect world we live in.

A subsidiary point to emphasize concerns the importance of the sequence of policy decisions. If one player makes its choice of a particular policy variable before another player, the Nash equilibrium is quite different than

if the two players choose simultaneously. The best-known examples arise, once again, from the study of imperfectly competitive firms. If there are two firms choosing one-period quantities, and the choices are made simultaneously, the Nash equilibrium is the Cournot equilibrium, which has already been referred to. If, on the other hand, one firm chooses output before the other, then the credible (or subgame perfect) Nash equilibrium requires that the first firm anticipate the response of the second. The outcome, which is known as the "Stackelberg" solution, will be quite different from the Cournot solution. A firm, in this case, gains an advantage in being able to act before its rival rather than simultaneously with it.

Outcomes: Cooperative or Non-cooperative

The third major element from game theory that I wish to draw upon concerns the comparison of cooperative and non-cooperative games. Non-cooperative games tend to give inefficient outcomes relative to cooperative games. If a game could be made cooperative; that is, if there were some way the players could sign binding agreements, then all players could be made better off. One way of looking at a provincial "code of conduct" is that it might be a way of trying to reach cooperative outcomes. Furthermore, non-cooperative games often have several Nash equilibria or several possible outcomes. Some of these outcomes are usually better, or closer to cooperative outcomes than are others. At the very least, a "code of conduct" might help provinces choose a preferred non-cooperative equilibrium.

Cooperative games normally have more than one possible outcome. The central issue becomes one of choosing between different efficient outcomes. In effect, it is the distribution of a fixed pie rather than maximizing the size of the pie that is essential in cooperative games.

In summary, the major ideas from game theory that I will draw upon in considering government policy are the Nash equilibrium as a solution concept, the significance of commitment and credibility constraints, and the role of a code of conduct in moving toward more efficient cooperative outcomes.

The classic work on the theory of games is by von Neumann and Morgenstern (1944), although much of their attention was devoted to a class of games of limited interest: two-person constant-sum games (games in which players share a fixed pool). A very good early general survey is by Luce and Raiffa (1957). A more modern general text is by Shubik (1982); and Friedman (1977) is a standard reference on applications of non-cooperative game theory to imperfectly competitive markets. The Nash equilibrium was first generally formulated by Nash (1950, 1951). Standard references on the credibility constraint in its various forms, aside from Schelling (1956), include Schelling (1960) and Selten (1975).

Reputation-building in games of incomplete information is described by Kreps and Wilson (1982).

Specific Policies

The objective in this section is to apply the game theoretic ideas described in the previous section to particular policy areas. The intent is not to be exhaustive, but to choose policy areas that provide good illustrations of how game theory can be applied. Three policy areas are considered: industrial policy, fiscal policy, and government services.

In focussing on only a few examples this study cannot do justice to the abundant literature on federal-provincial relations and on provincial policy making in Canada. One important point concerns how particular central government policies affect the game structure faced by provinces. As an example, high provincial minimum wages might be explained in part as responses to (partial) federal funding of unemployment insurance. Other examples of provincial responses to federal policy can be found in Courchene (1980) and elsewhere. In any case, I emphasize that the issues taken up here are illustrative and important, but not by any means comprehensive.

Industrial Policy

In this study industrial policy is taken to be any policy designed to influence the industrial structure of a province. A direct form of industrial policy is simply offering tax concessions or subsidies to particular firms to locate in the province in question. Another indirect form of industrial policy is investment in infrastructure: roads, port facilities, communications systems or whatever, so as to attract particular types of industry.

The basic problem arising from provincial rivalry in using tax and subsidy policy to influence industrial structure can be captured fairly easily. Consider the following simple game. A foreign firm is choosing between two provinces concerning the location of a plant. There is a net benefit or rent, denoted R, associated with this plant. This benefit will be divided among profits to shareholders of the firm, payments above opportunity cost to workers and tax revenues to the provincial government.

If there is only one government involved, the firm and government can bargain over their shares of the rents. The government might even have a bargaining advantage. If, however, there are two provinces in contention for the plant they will, if they act non-cooperatively, bid against each other. If the firm is really indifferent between the two locations, apart from tax advantages, and the provinces are symmetric, the Nash equilibrium in taxes involves no net benefit to either province.

The reasoning runs as follows. If province A has a lower tax rate than province B, then province B is going to get no benefit whatsoever if it

stands pat, for the firm will locate in A. It thus has every incentive to undercut A as long as some residual net benefit, however small, remains. Once it does undercut, province A is in the position that B was in formerly. This process will continue until net benefits to the winner are driven to zero. What if the provinces happen to be in a tie? In this case the provinces still have an incentive to undercut according to the Nash rules, because each province is assumed to take as given the tax set by its rival, and so can, from its point of view, attract the plant for certain if it lowers its tax only slightly. Getting a marginally smaller return for certain will always dominate a 50 percent chance of a marginally larger return and undercutting will continue even if ties emerge along the way.

If there is some net benefit to local workers, in the event that the plant is successfully attracted, then the provincial government, if it is concerned with the general public interest, including the interests of these workers, will have an incentive to offer larger and larger subsidies to the firm until the magnitude of the subsidy is equal to the net benefit to the workers.

This structure is identical to the Bertrand (1883) model of price-cutting by firms. Like that model it is subject to the criticism that it is too extreme — more extreme than is suggested by reality. The real world is more complicated than this. Economic agents, including provincial governments, are normally more sophisticated than suggested by this model. Furthermore, provinces are not symmetric and they also face more than one decision at a time.

The value of this description is that it does capture, in the purest possible setting, non-cooperative incentives faced by provincial governments. Real policy decisions certainly have an element of this rivalry, leading to outcomes that reduce national welfare.[14]

A modification of the basic structure arises from the recognition that each province faces a whole array of possible investments, and that some investments, those for which the province in question has a particular advantage, will be attracted even if the tax rate is higher than elsewhere, while other investments are long shots even at low tax rates. Any particular tax rate, given the tax rates set in other provinces, will attract some investments and not others. Considering once again the two-player case, the objective functions for provinces A and B can be written, respectively, as

$$T^A = T^A(t^A, t^B); \; T^B = T^B(t^A, t^B) \tag{1}$$

where t^A and t^B are the tax rates set by the provinces.

Formally, province A tries to maximize T^A through its choice of t^A, taking t^B as given. Mathematically, this is represented by taking the derivative of T^A with respect to t^A and setting it to zero. Similarly, province B is trying to maximize T^B through its choice of t^B, represented by setting the derivative of T^B with respect to t^B equal to zero.

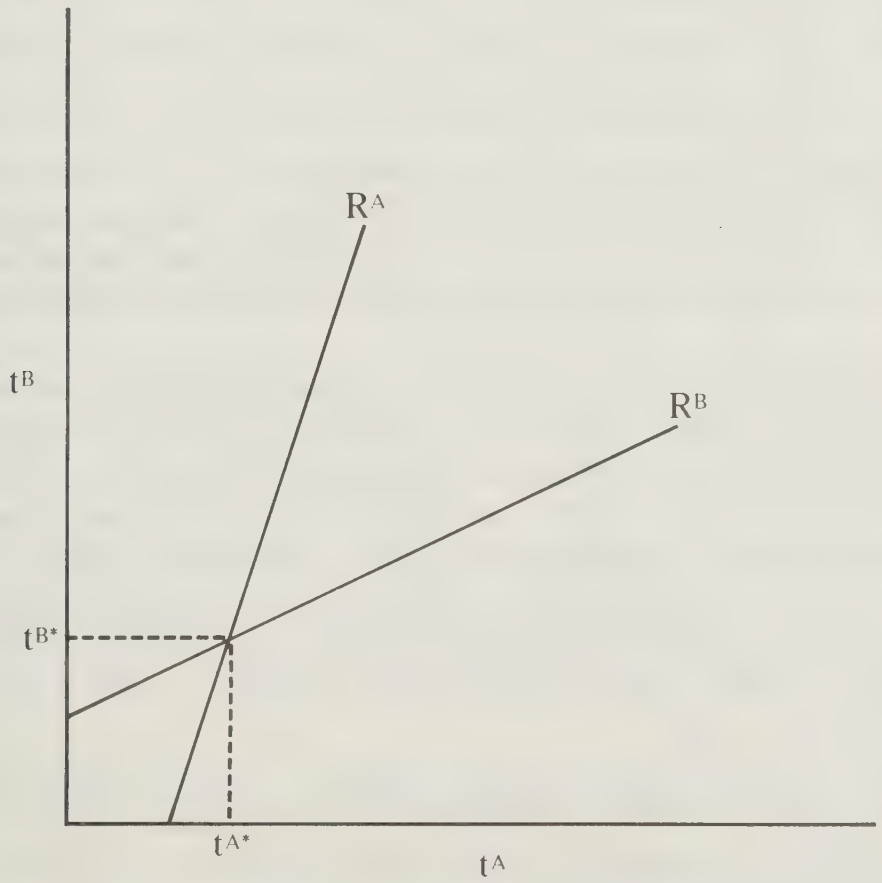
$$\partial T^A/\partial t^A = 0. \tag{2}$$

$$\partial T^B/\partial t^B = 0. \tag{3}$$

Condition (2) represents the optimal choice of t^A for any given value of t^B. If t^B, the tax rate of province B, were different, then the best value of t^A for province A would be different. For example, if province B were charging a very low tax rate (or offering tax concessions), then province A would find that its best or optimal tax rate was also low; otherwise most of the attractive investments would flow to province B. If, on the other hand, province B were charging a high tax rate, then the optimal choice by province A would also be to charge a reasonably high tax rate, for it could now charge higher taxes without losing as much potential investment.

For each particular choice of t^B there is an optimal value for t^A. The relationship describing the optimal value of t^A for each different possible value of t^B is sometimes referred to as the "reaction function" for t^A. Correspondingly, expression (3) represents the reaction function showing the best response of t^B for any given value of t^A. The Nash

FIGURE 2-1



equilibrium in tax levels occurs when both reaction functions are satisfied simultaneously, which is the point of intersection in Figure 2-1. At this point of intersection, each province is choosing the best tax rate it can, given the tax rate chosen by the other province.

The (non-cooperative) Nash equilibrium can be compared with the joint maximum that would result from either centralized authority or fully cooperative behaviour. This joint maximum is obtained by maximizing the sum of T^A and T^B through the choice of t^A and t^B. Let T denote this sum:

$$T(t^A, t^B) = T^A(t^A, t^B) + T(t^A, t^B). \tag{4}$$

The maximum of T is obtained formally by setting the derivatives T with respect to t^A and t^B to zero, yielding:

$$\partial T/\partial t^A = \partial T^A/\partial t^A + \partial T^B/\partial t^A = 0. \tag{5}$$

$$\partial T/\partial t^B = \partial T^A/\partial t^B + \partial T^B/\partial t^B = 0. \tag{6}$$

Expressions (5) and (6) can be compared with (2) and (3). Comparing (2) and (5) shows that in the Nash equilibrium the term $\partial T^B/\partial t^A$ is ignored. In other words, in non-cooperatively setting its tax rate, t^A, province A does not take into account the cost it imposes on province B. The terms $\partial T^A/\partial t^A$and $\partial T^A/\partial t^B$ therefore represent the spillovers or externalities of non-cooperative decision making. Because these externalities exist, the non-cooperative or Nash equilibrium is inefficient from the national point of view. There is room for both provinces to be better off. In particular, the non-cooperative solutions give rise to lower tax rates than do the cooperative solutions. This illustrates the basic point that tax competition between provinces will lead to suboptimal tax rates and foregone tax revenue. Adding more provinces would make the problem worse.

So far we have made the assumption that the investments in question are from foreign sources. In this case the costs of tax competition are obvious. Competition between provinces simply transfers wealth to foreign shareholders, which is presumably unattractive from the national perspective. What happens to the argument if some or all of the investments in question are from Canadian sources? Then this competition between provinces simply transfers wealth from Canadian taxpayers to Canadian shareholders. There is, then, apparently no obvious case for saying the outcome is good or bad.

Nevertheless, there is still a net welfare cost to the provincial rivalry. In general, governments perform important services and these services must be financed. If governments act in the public interest, various activities will be taxed in such a way that the marginal welfare cost of the tax will

be equalized in all areas. This will include a tax on corporate income. This interprovincial rivalry, by inducing tax concessions in certain areas, will cause taxes in other areas to rise and total revenue and services to fall, lowering the overall welfare level that is reached.

One's natural inclination is to think that these secondary tax burdens are of second order compared to the pure transfers of rent that arise in the foreign investment example. However, Usher (1982) presents an (admittedly arbitrary) example in which the secondary burden of raising tax revenue is comparable to the amount of tax revenue raised: raising a dollar of tax revenue reduces private wealth by one dollar and in addition causes an extra efficiency loss of roughly one dollar.[15] If Usher's example is representative, then competition, even over purely domestic sources, would cause large inefficiencies.

The industrial policy tax game is similar in structure to the problem of choosing provincial inheritance taxes: each province has an incentive to undercut the other and in the Nash equilibrium, very little tax revenue flows into provincial treasuries.

The simple analytical structure described here does, I think, capture the basic problem with competitive tax setting. There is a cooperative solution, which is better for both provinces than the non-cooperative Nash equilibrium. At the efficient solution, however, each province faces an irresistible temptation to defect by undercutting, and get short-run benefits. The efficient solution is thus not an equilibrium outcome. This is similar to the so-called "prisoners' dilemma," and is identical to the standard problem faced by a cartel, such as OPEC, in trying to maintain high collusive prices.

The next extension to consider is the construction of provincial infrastructure as a tool of industrial policy. In this framework, provinces face a two stage decision process. In the first stage, a decision is made about infrastructure and in the second stage, tax and/or subsidy rates are set. Other things equal, a more attractive infrastructure will raise the benefits to firms from undertaking economic activity locally, and so will raise the tax revenues that the government can expect to receive. In a simple world, we might expect it to make sense for governments to build roads, bridges, port facilities and the like, then recoup the costs from taxes on the beneficiaries.

The efficient outcome would involve investing in infrastructure just up to the point where the marginal cost of additional investment was equal to the marginal benefit in taxes and surplus of various sorts. However, provincial rivalry in infrastructure will generally lead to provincial incentives for overexpansion.

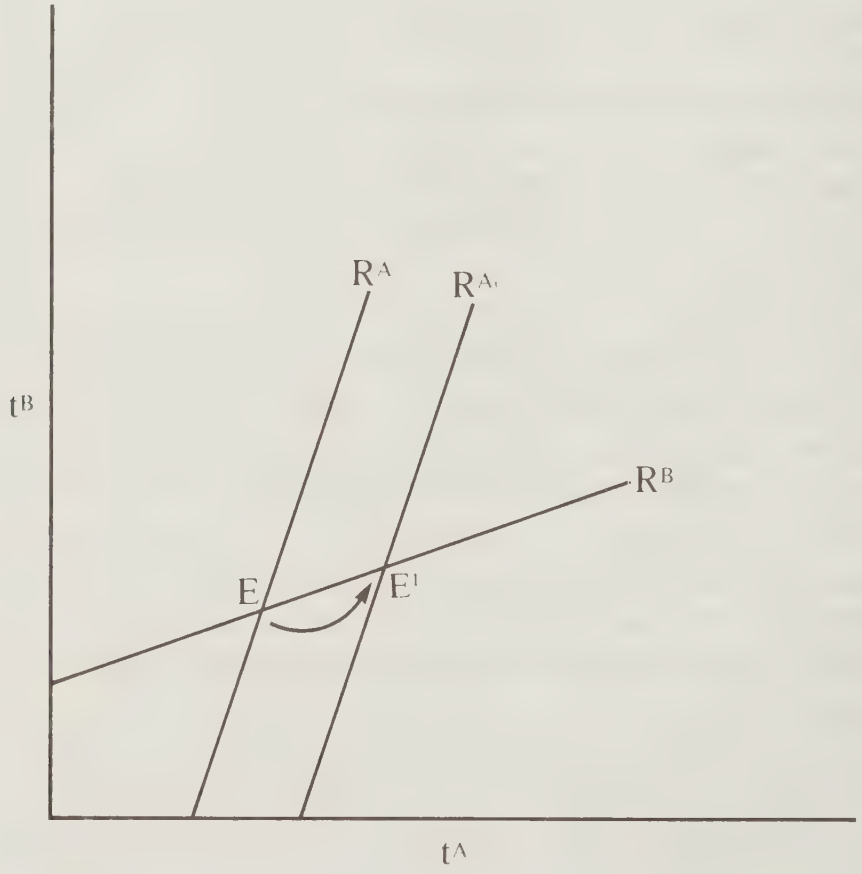
Modelling this idea formally is somewhat more complicated than just looking at a simple Nash tax equilibrium. The structure is similar to Brander and Spencer (1983) and draws on the oligopoly models associated with Dixit (1980) and Eaton and Lipsey (1980). The difficulty arises because

the Nash equilibrium in taxes will, of course, be influenced by the infrastructure in each province. More infrastructure induces a greater "supply" of investment projects by firms, for given tax rates, thus altering the decision problem faced by firms. The solution tax rates will therefore be functions of the levels of infrastructure. Letting I^A and I^B represent investment in infrastructure in provinces A and B, respectively, we can write:

$$t^A = t^A(I^A, I^B); \; t^B = t^B(I^A, I^B). \tag{7}$$

The nature of this relationship can be understood by considering the reaction function diagram. An increase in I^A means that province A is more attractive and will raise the tax rate, t^A, that is optimal for that province to charge, given any tax rate by province B. In short, the reaction function for province A shifts out, leading to higher taxes for both provinces as indicated by new intersection, E^1, which is the new equilibrium, as shown in Figure 2-2.

FIGURE 2-2



In effect, tax rates are determined by I^A and I^B so the game reverts over the choice of I^A and I^B. The selection of I^A by province A now must incorporate three considerations. First, increases in I^A make province A a more attractive investment target and increase provincial benefits from

investment. This added benefit should be compared with a second effect: the cost of infrastructure. To achieve overall efficiency, infrastructure should be added up to the point where extra benefits are just offset by extra costs.

There is, however, a third effect. Increases in I^A will raise the Nash equilibrium tax rate of province B, as illustrated in Figure 2-2. This effect might be referred to as a strategic effect and Province A will take it into account in choosing I^A. In essence, the selection of I^A and I^B influence the conditions of the tax game that the two provinces will play. Because of this strategic effect, there is an added incentive to install infrastructure, beyond simply attracting investment.

This added incentive to install infrastructure is really a reflection of the credible threat aspect of the game structure. By investing in extra infrastructure, province A creates a commitment to charge a higher tax rate on private investment. Furthermore, the higher tax rate for province A will induce province B to charge a higher tax rate as well (as shown in the reaction function diagram). In effect the investment by province A indirectly causes province B to charge a higher tax rate in the later period. The investment in infrastructure is therefore an investment directed toward influencing the behaviour of the other province. Both provinces face similar incentives, leading to similar overinvestments in infrastructure. These investments are wasteful from the combined point of view. Each province uses up real resources in trying to get the other to charge a higher tax rate. In principle, the two provinces could simply agree to charge the higher tax, avoiding using up real resources. The problem is that non-cooperative or unilateral incentives make such agreements difficult to obtain and adhere to.

It should be emphasized that such reasoning assumes that provinces correctly foresee the consequences of changes in infrastructure on the tax rate equilibrium. This is an example of the so-called "subgame perfect" or "credible" equilibrium. Once again, the model represents a stark and perhaps extreme portrayal of government policy. Obviously one should not claim that governments have the single-mindedness or the information assumed here. The analysis does, however, capture an important central tendency of non-cooperative rivalry in provincial policy. Strategic effects lead to incentives for overinvestment in certain types of infrastructure.

Fiscal Policy

Fiscal policy refers here to the net deficit or surplus position of a government. Discretionary fiscal policy is the use of budget deficits (or surpluses) to influence aggregate demand in the pursuit of macroeconomic stabilization, and in most countries is generally regarded as the natural domain

of national governments. In Canada, however, there has been considerable attention paid to discretionary provincial fiscal policy.

The normal line of argument (see Oates, 1972) is that provinces, if left to themselves, would undertake too little discretionary fiscal policy because the benefits of fiscal policy accrue largely to other provinces. Consider, for example, a standard case of Keynesian deficient aggregate demand, with the associated unemployment. Suppose Alberta undertakes an expansionary fiscal policy, increasing local demand for goods and services. As Albertans experience increases in their disposable incomes they will demand more consumption goods, but most of this increased demand would be demand for goods produced outside Alberta. The rest of Canada would expand, benefiting from a debt undertaken by the taxpayers of Alberta.

Because of this external effect, the government of Alberta, which we assume to undertake policy action only up to the point at which marginal costs to Alberta equal marginal benefits to Alberta, will undertake too little fiscal policy from the national point of view. All provinces will be in the same position, leading to underactivity in fiscal policy.

On the other hand, it might be argued that the current residents of one province, like Alberta, regard themselves as potentially mobile to the rest of Canada. In the event, they would not regard provincial debt as a cost to themselves, since the future tax liability could always be avoided by moving. Such an incentive structure could lead to overspending rather than underspending on expansionary fiscal policy.

In any case, neither of these lines of reasoning is an argument against provincial fiscal policy, provided the national government is also a player. Consider a situation in which all provinces, more or less simultaneously, announce and pass budgets, followed by a federal government budget. The structure of game theory suggests that provinces should anticipate the procedure by which the federal government sets fiscal policy, and that the federal government should consider the fiscal stance of provinces before deciding on its final policy. In this framework, provinces might still have an incentive to underinvest or overinvest in fiscal policy, from the national point of view. However, the federal government can then simply "top up" the sum of provincial policies to the appropriate level. This is a fairly important general principle. In cases of positive external effects, there is no loss of efficiency in allowing provincial policy to be undertaken. One would not want to assign complete policy authority to the provinces, or even allow them to act immediately after the federal government, but having provinces act first, followed by federal policy, will achieve the optimum in this framework.

Services

The most important activity of provincial governments is in providing services. For most services the strategic interdependence between provinces

is relatively minor; however, as mentioned in the introductory section on fiscal federalism, migration effects can cause interdependencies. To the extent that migration effects are recognized, each province has an incentive to encourage out-migration of people who impose net costs on the province they reside in, and to encourage in-migration of people who confer net benefits.

Migration effects, especially in connection with equalization payments, have been carefully studied elsewhere.[16] The following example illustrates the main principle of strategic interaction. Each provincial government is concerned about unemployment. Furthermore, any temporary local reduction in unemployment below the level commensurate with (although not necessarily equal to) the levels of unemployment in other provinces tends to induce in-migration until a new equilibrium pattern of unemployment emerges.

Provincial governments consequently have an incentive to discourage or penalize out-of-province job seekers, and a Nash equilibrium in employment policies would certainly involve some impediments to labour mobility. If all provinces raised barriers to labour mobility there could be no net benefit to Canadian workers as a whole, and in addition the overall efficiency of the Canadian labour market would be reduced, with each worker's options much more limited than before. This particular example of non-cooperative inefficiency seems to have been well recognized, although some barriers to interprovincial mobility remain. On the whole, however, decentralization of direct control over internal migration seems unlikely.

Aside from migration effects, provincial services may interact in other ways. In particular, any service, such as support of basic research, that has a public good aspect will tend to be underprovided by decentralized provinces.

Private Interest Government

The preceding analysis makes two very important assumptions about government. First, provincial and federal governments are assumed to have equal (and complete) information; and second, each government is assumed to act in the (well-defined) interests of its constituents. Each provincial government acts on behalf of its residents, and the national objective function is nothing other than the sum of provincial objective functions.

In this structure a central government can do no wrong, while provincial governments, because of their interdependence, pursue national objectives inefficiently. Just as a cartel can always improve upon the profitability of a previously non-cooperative industry, a central government can always improve upon the performance of non-cooperative provinces.

Relaxation of either the complete information assumption or the public interest assumption greatly changes the basic message. In this section the assumption regarding public interest is relaxed. When the assumption that governments are not wholly benign is made, the resulting analysis is often thought to be a mixture of politics and economics, rather than pure economics. This is surprising in certain respects because "private interest" or "rent-seeking" theories of government arise from the idea that framers of policy — elected officials and bureaucrats — are economic agents, like anyone else, and so are principally interested in their own welfare. If incentive schemes can be set up so that their interest coincides with the public interest, then we can have confidence in the value of government policy. If not, then enlarging the scope for government activity enlarges potential inefficiency.

The following extreme example will make the point. Consider a nation of two provinces: province A and province B. Central governments do, for simplicity, two things: they provide public goods, like courts and national defence, and they can transfer income from one province to another, using taxes and transfers. Furthermore, it is possible for residents of provinces A and B to devote resources to influencing government policy. The net transfer, R^A to province A depends on its own efforts, E^A, and on the efforts of the other province, E^B.

$$R^A = R^A(E^A, E^B); R^B = R^B(E^A, E^B). \tag{8}$$

R^A is increasing in E^A and decreasing in E^B: given any effort level from province B, more lobbying effort by residents of A increases the net transfer to province A. Furthermore, $R^A + R^B = 0$. One province's gain is, of course, another's loss as far as pure transfers are concerned. From the national point of view, E^A and E^B are pure waste in that they cannot increase aggregate welfare, but do subtract from resources available for productive use. The Nash equilibrium occurs where

$$\partial T^A/\partial E^A = 0; \partial T^B/\partial E^B = 0. \tag{9}$$

This equilibrium will not occur where $E^A = E^B = 0$; it will occur where the marginal value of extra transfers is equal to the marginal cost of extra effort, from each province's point of view, and this will occur at positive effort levels. If, however, the provinces are symmetric, actual transfers R^A and R^B will be zero. A lot of effort will be expended to no effect. The situation is rather like a tug-of-war with both sides pulling hard, but with no net movement. If both sides would stop pulling, the same net outcome would occur and participants would use up less effort, but neither side can afford to reduce effort unilaterally, for it will simply lose.

Suppose, however, that government is decentralized so that interprovincial transfers are no longer possible. Public goods might be provided less efficiently, but society would immediately save E^A and E^B.

This is a very stylized example, but the point is clear. If government policy can be influenced by expenditure of real resources, then wide-ranging government creates wide-ranging incentives for activities that are in the private interest of those involved, but that are wasteful from the national point of view. This is an example of so-called "rent-seeking" behaviour.

Even if efforts are not expended to influence government policy, inefficiency can result simply from the strategic effects of voting. Elected officials announce policies concerning transfers. We recognize, however, that transfers are not costless. To raise money for citizens of province A, citizens of province B must be taxed. This tax will distort behaviour in province B and will create a secondary loss in the economy. In effect, the net benefit to A is less than the net cost to B. If, however, the losses are more concentrated than the benefits, vote-maximizing politicians will have incentives to announce such transfer policies, even though they are socially inefficient.

Interestingly, this is one case where pure voting models give rise to different predictions than rent-seeking models. With pure voting, majorities can take advantage of minorities, while with rent-seeking it is usually argued that a small group with a lot to gain will lobby more intensively than a large group, each member of which has only a small amount to lose. Thus, tariffs are often viewed as the outcome of a rent-seeking process. The important point is that, in either case, aggregate benefits and costs of particular policies are not the determinants of policy, which leads to inefficiency. It has, however, been argued by Downs (1957), among others, that voting has some important efficiency properties.

I do not mean to suggest that central governments should not be in the business of redistributing income. I do wish to emphasize that a "private interest" view of government suggests that there will be incentives set up to undertake transfers that have little to do with fundamental value judgments or humanitarian objectives, and that impose a net loss of efficiency on the economy.

The examples described here seem so transparent in their pure form that waste might be avoided by simple agreement. However, most government policies have an important element of rent transfers in them. If the federal government builds a docking facility in Vancouver, that is partly a transfer from the rest of Canada to British Columbia, to the extent that rents are transferred to B.C. residents. (The dock also has obvious productive value.) Provincial residents have very little incentive to consider whether the general benefits exceed actual construction costs; instead, their natural view is that the more the federal government pays, the better, and so they

have an incentive to invest resources in influencing federal policy. Meanwhile, of course, there are transfers from British Columbia to other provinces embodied in federal projects in those provinces. The net transfers to all provinces must balance to zero, but that does not prevent wasteful lobbying, nor does it prevent a general incentive for inefficiently high levels of government expenditure.

Some of the most important reasons for decentralization have to do with the theory of bureaucracy. To consider the role of bureaucracy, it is necessary to distinguish between three sets of economic agents: the public, elected officials, and the bureaucracy. If one takes a "public interest" view of government, the bureaucracy has no particular role to play; it simply helps the elected government act in the public interest. If, however, bureaucrats are recognized as individual agents with their own objectives, then the role of the bureaucracy becomes important.

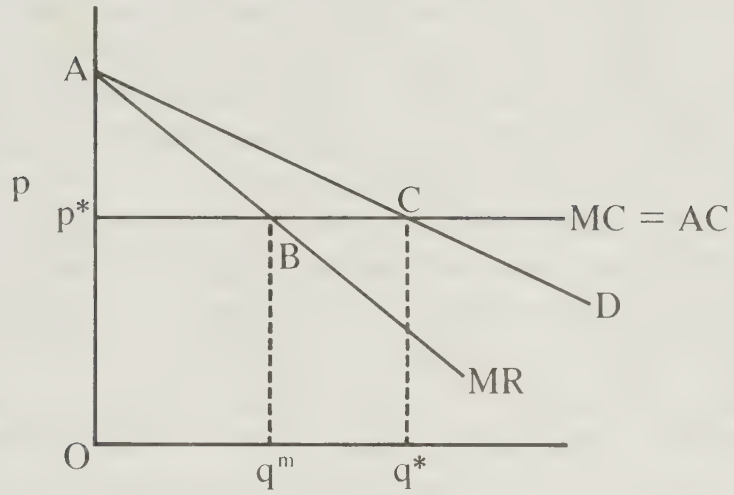
There is still the problem of formulating the objective of the bureaucracy or, more accurately, the problem of selecting the best simplifying assumption to abstract from the complex motivations of any real group of individuals. The two prominent suggestions (aside from the public interest view) are maximization of budget size and maximization of "slack," which is the difference between the budget of the bureau and the minimum cost of carrying out the bureau's activities. The budget size principle derives from the idea that higher budgets imply higher salaries and greater prestige to the head of a bureau, who will thus always try for more bureau growth.[17] The "slack" concept is by analogy to the profit of a private firm. Of course "slack" does not appear as profit in any accounts since the bureau's costs will always equal its budget; it will appear as extra costs that are not really necessary to produce the output of the bureau but that make life more pleasant for high-level bureaucrats: nice offices, thick carpets, expense accounts, extra secretaries, salaries above opportunity cost, and so on. For a fixed set of activities or output, maximization of "slack" and budget maximization are equivalent.

The setting is as follows: a bureau provides a set of services, for which it receives a budget. The elected government, acting, we assume, on behalf of the public, would like these services produced at minimum cost, but it does not know the true cost structure. Instead, the bureau submits a budget request which the elected government accepts or rejects.

The differences between a bureau providing services and a private firm are, first, that the bureau sets a total budget for a certain amount of service, in contrast to private firms, where output is usually provided at a certain price per unit, like ten cents per pencil. Furthermore, there is no bidding process; in effect the bureau has a monopoly.

The line of reasoning associated with, among others, Niskanen (1971) suggests the method of analysis. How would a monopoly, allowed to make all or nothing offers, proceed? A simple demand curve provides the answer.

FIGURE 2-3



A competitive market would provide q^* at price p^* with surplus Ap^*C going to consumers. Output is provided efficiently since price equals marginal cost. A private monopoly which sold output on a per unit basis would produce q^m, where marginal revenue equals marginal cost, leaving surplus ABp^* for consumers. A monopolist allowed to make all or nothing offers would produce q^* at a total cost of ACq^*O, leaving no net surplus to consumers. In effect the monopoly bureau would extract the maximum amount that consumers (or the government, acting on their behalf) were willing to pay. Area Ap^*C would be slack.

This is, of course, an extreme version. As pointed out by Spencer (1979, 1980), the bureau could only extract the total surplus in cases in which the government had very little information about costs. Also, true "all or nothing" budget decisions are relatively rare, especially in Canada. In general we would expect relatively less slack to be extracted if the elected government could bargain over the budget, and if it had good information or if there were implicit competition between bureaus or between individual public sector managers.

In the stylized model underlying the preceding discussion, decentralization would have the advantage of providing both more information and competition. There may even be direct competition between services provided by different levels of government. One of the rare examples of this is the case of towns in most provinces that have the option of choosing RCMP police services or of setting up their own police departments. Even without direct competition, bureaus in different provinces compete with each other. If there is only one bureau providing some service, it is hard to judge good performance by the bureau head, since there is little basis for comparison. If there are ten bureaus providing similar services, salary, promotion and demotion can be linked to relative performance, which provides an incentive for bureaucrats to do something other than maximize slack.

This section is not meant as a general criticism of bureaucracy. Some goods and services are more efficiently provided by public bureaucracies than by private firms. However, to the extent that the behaviour of bureaucrats is governed by normal economic incentives and not altruism, decentralization provides implicit competition and has, therefore, certain efficiency properties. It also has inefficiencies, of course, and the difficulty is to compare these advantages and disadvantages.

In other words, the important question, as far as fiscal federalism is concerned, is whether decentralization contracts or expands the scope for socially wasteful rent-seeking and bureaucratic inefficiency. Incentives for rent-seeking arise at all levels of government. It is conceivable that large jurisdictions could raise the costs of rent-seeking and lower the chances of success to the extent that centralization might actually reduce the social costs of rent-seeking. I know of no systematic attempt to assess the evidence on this point. Anecdotal evidence from the United States concerning civic and even state politics seems to suggest that small jurisdictions are very prone to rent-seeking. The only point that is certain is that incorporation of rent-seeking into economic models of government raises additional sources of inefficiency at all levels of government and may either strengthen or weaken the case for centralization.

A Code of Conduct

A provincial "code of conduct" would be an agreement designed to limit the inefficiencies associated with decentralization. Looked at from a game theoretic point of view, there are two roles a code of conduct might perform. First, it might be viewed as having the force of law; such a code would simply impose an efficient cooperative solution on provincial governments. Any one province might have an incentive to depart from the prescribed behaviour, but would be prevented from doing so because it was compelled by law to abide by the agreement. A code of this form would effectively act as a substitute for centralized control.

A weaker role for a code of conduct to play is as a mechanism to solve "games of coordination." In games of coordination the participants remain non-cooperative agents; they do not act altruistically, but act instead in their own self-interest. In a game of coordination there are two or more possible equilibrium outcomes, one of which is better for the participants than the alternatives. The problem is to choose strategies so that the best of these possible equilibrium outcomes emerges.

To illustrate a game of coordination in its simplest form, consider the following situation. Two cars are driving along a one-lane road in opposite directions. They approach each other. As they approach, each driver has three strategies: swerve left, swerve right, or apply brakes. If both cars swerve right or left, the cars pass and all is well. If one swerves left while the other swerves right, the cars crash, with large negative payoffs

to each driver. If both cars brake there is a minor collision with minor damage. If one brakes while the other swerves either way, both cars sustain moderate losses.

If players could agree to a code of conduct that, whenever cars met, each would swerve right, then the game would work out efficiently. This is a game of coordination. In the absence of such a code of conduct an inefficient solution would arise. In the case of driving, custom or tradition acts as a code of conduct. Canadian drivers are accustomed to swerving right, hoping the other driver is not a visitor from England. In policy making, custom can play a similar role, but may take a long time to develop efficiently and, in a changing environment, may never achieve efficiency. A code of conduct, on the other hand, can solve games of coordination relatively easily. The second prisoners' dilemma game, described in the section on game theory, is also a game of coordination.

Games of coordination arise commonly in policy problems. For example, a situation where policy choices are repeated indefinitely is a game of coordination. As indicated in the section on game theory, we can imagine strategies of the form: charge the cooperative tax rate next period if every other player charges the cooperative tax this period. If another player defects, then I will defect also at my next opportunity and continue to defect thereafter. Such strategies are referred to as "trigger strategies." It can be shown that such strategies constitute a Nash equilibrium for games that are repeated in perpetuity, provided the future is not discounted too heavily. Each province charges the cooperative tax rate in period *i*, rather than defecting by undercutting, because the temporary benefits from undercutting are offset by the potential long-run losses from retaliation.

There is, however, another possible Nash equilibrium that involves each province paying the one-shot non-cooperative tax rate every period. Each province would be doing its best, given the action of the other. The choice between these two Nash equilibria is a game of coordination. If provinces can get together to agree on the efficient outcome, supported by the (credible) threat that if one province defects others will follow, then the efficient solution is self-enforcing. In effect, defection is punished.

One problem with this multiperiod cooperation is the so-called "unravelling" that occurs if there is a last period. If a government is in the last period of its term and is prepared to let the future take care of itself, it has an incentive to defect or cheat in the last period, getting the temporary benefits from undercutting its rivals and not suffering the costs of future retaliation, since there is no future to be concerned about. All governments recognize that this incentive exists and consequently recognize that the "last" period will be characterized by cheating. In this case, there is nothing to be gained by cooperating in the second to last period, since there is going to be defection by others in the last period anyway. As a result, any one government has an incentive to defect in the penultimate

period. All governments recognize this, however, leading to incentives to defect from the cooperative agreement in the third to last period. This logical unravelling of the cooperative solution extends all the way to the first period.

This unravelling of cooperative solutions in repeated games of extensive but finite length is regarded as something of an anomaly in game theory. It can be removed by incorporating any one of several types of uncertainty.[18] In any case, my view is that coordination of any sort is unlikely without explicit agreements, as in a code of conduct. The important point to be made concerning codes of conduct is that they can solve games of coordination: they can allow the best of several non-cooperative equilibria to be chosen.

Now we turn to codes of conduct that have the force of law. Such a code of conduct can turn a non-cooperative game into a cooperative game. The central focus of cooperative games is not efficiency, but distribution. Game theorists normally assume that the outcome of a cooperative game will be Pareto-efficient. If it were possible to increase the welfare of one or more participants without harming the others, surely it would always be done, especially if the gainers could offer inducements (known as "side payments") to the neutral players so as to make them gainers as well.

In most of the games we have considered so far, there is only one efficient solution: the cooperative outcome is obvious. This results from the simplifications used to focus on the fundamental properties of non-cooperative games. The cooperative point was useful for comparison. In general, however, there are many efficient outcomes that provide different distributions of the benefits to the players. Unfortunately, there is no single solution concept that is generally accepted, so it is hard to choose one of several efficient outcomes as the likely solution. There are several candidates (including, incidentally, a concept called the Nash bargaining solution, which has no conceptual relationship to the non-cooperative Nash equilibrium). Most proposed solution concepts are such that the payoff to any player is proportional to the damage it could do if it withdrew and behaved non-cooperatively, which suggests that large participants might have advantages over small ones. More detailed consideration of cooperative games is beyond the scope of this study.

One final point should be made about codes of conduct and the role of central government. The central government might well act as a broker in helping provincial governments solve games of coordination, or it might even take a stronger position and impose a code of conduct with the force of law. Any attempt by provincial governments to coordinate decisions could perhaps be viewed as an attempt to create or restore functions that a central government would normally have.

Extensions and Concluding Remarks

This study has made several simplifying abstractions in order to focus on the central insights of game theory. In particular, many of the examples have assumed only two provinces or players, and almost no attention has been paid to asymmetries between players. Rather obviously, there are more than two provinces in Canada, and asymmetries of size and resource base among provinces are fundamental to Canadian policy making.

One important question is whether large players do well at the expense of small players in non-cooperative games. The natural presumption is probably that large players do have some advantage. This presumption is, as far as I know, unsupported by any general theoretical framework. Either the small or the large player can do relatively well, depending on the specific game being played. First of all, by a large player we mean a player whose policy decisions have a major impact on other players, while a small player is one who has relatively little impact on his rivals. For example, Canada's monetary policy has a measurable but small effect on U.S. economic activity, whereas U.S. monetary policy has a major impact on Canada: Canada is a small player and the United States a large player in international monetary affairs.

The essence of a non-cooperative game is that each player ignores the welfare consequences of his policies for his rivals. In effect, non-cooperative games are characterized by externalities. If this externality is negative, then the small player suffers from the inefficiency much more than the large player. If Canada and the United States both undertake policies which lead to acid rain, and the United States is ten times as large, and produces ten times as much acid rain, then Canada is burdened with a negative effect ten times as great in absolute size and a hundred times as great in relative size. On the other hand, if the external effect is positive, the small player benefits much more in both an absolute and relative sense: the small player becomes a free rider. For example, Canada is largely a free rider on U.S. defence and on U.S. primary research. In the two-player non-cooperative game, where one player is small and the other large, the question of who benefits more turns on whether external effects are beneficial or harmful. A similar principle applies in many-player games.

In cooperative games, the issue is less clear. One feature of cooperative games that has not been discussed so far is coalition formation. Implicit in cooperative games is the idea that subgroups of players can sign binding agreements. Such subgroups are called coalitions. Different combinations of players can try to exploit other players. The overall outcome might be efficient: the total size of the pie is maximized, but there is still wrangling to be done over who gets which piece. Imagine a game with two large players and one small player. The larger players have little to gain by "ganging up" on the small player, because its natural share is small to begin with. However, the small player might be able to do well by threat-

ening to join a coalition with one of the large players. This is only one of many possibilities, however, and I know of no general principles that apply. For a specific game structure, one might be able to make clear predictions.

One way of expressing the central theme of this study is to ask whether "competition" between different governments is efficient, or at least, in what circumstances competition is desirable. The value of competition in the marketplace is that it induces firms to strive to serve consumers well, even though their primary interest is to earn profits by extracting as much from consumers as possible. Competition between firms protects consumers. The analogy in public policy is that competition between governments might be beneficial if it is necessary to protect citizens from the self-interest of politicians and bureaucrats, and if ordinary voting is insufficient protection. Governments might be forced by competition to offer efficient services in return for tax revenue.

If governments are benevolent and well-informed, there is no role for such competition. Competition or rivalry will lead to inefficiency because of the strategic structure of external effects. Either a central government or a binding code of conduct would be necessary to restore efficiency.

One can argue, however, that provincial cooperation should not be regarded as necessarily benign. If provincial policy makers have their own private interests to pursue, they might well agree, in a code of conduct, to suppress socially constructive competition among themselves, and produce nationally suboptimal policies. For example, if provincial policy makers prefer not to deal with the difficulties caused by interprovincial movement of labour and capital, they might agree to various barriers to mobility. If, therefore, the objective of inducing competition between governments of different jurisdictions is to protect citizens from the excesses of government, a code of conduct is not desirable, just as a cartel of firms is not in the interest of consumers.

One other point that should be emphasized is whether some levels of government are more prone to abuse than others. Perhaps voting polices governments of large jurisdictions more effectively than it does those of small jurisdictions.

This study suggests that the problems associated with economic policy formation in a federal state can be cast in a game theoretic structure. Game theory, however, is a set of tools, not answers, and the problems do not become much easier just by expressing them in formal language. Nevertheless, such expression does promote clear thinking. We should not be surprised if non-cooperative tax competition between provinces leads to major inefficiencies in the tax system, for this is a clear prediction of widely accepted game theoretic models. Nor should we be surprised to see governments undertaking investments with the objective of establishing credibility for future policies. A code of conduct can, to some extent, act as a

substitute for central control in limiting the costs of rivalry between governments.

Finally, the outcome of any strategic or setting "game" depends on the objectives of the players, in this case governments. Therefore, all analysis is contingent on the assumption made about government behaviour: whether governments act in the public interest or are the amalgam of various private interests. Government behaviour is not, of course, truly exogenous, but is dependent on the incentive structure and strategic structure within the government itself. Consequently, at least some attention should be paid to designing internal government incentives in such a way as to promote public interest government, even if decision makers themselves are self-interested like the rest of us.

Notes

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I would like to thank Ken Norrie and two anonymous reviewers for many thoughtful and helpful comments. I am also grateful to Sam Wilson and other participants of the May 1984 Federalism/Economic Union seminar held in Ottawa.

1. A good general reference is Oates (1972).
2. Economic efficiency is a well-defined concept in economics, sometimes referred to as Pareto efficiency. Any textbook on microeconomics or public finance will have a discussion of Pareto efficiency. Good examples are Boadway (1979) and Tresch (1981). Formally a situation is defined as pareto efficient if no person can be made better off without making someone else worse off. A pareto-efficient state is a state without waste. Very often a weaker notion of efficiency is used, based on potential pareto improvements and potential compensation.
3. The antecedent of modern public choice is Wicksell (1896). Modern development is associated largely with James Buchanan and Gordon Tullock, and with Anthony Downs. See in particular Buchanan and Tullock (1962), Downs (1957), and a survey of public choice theory by Mueller (1979).
4. The early development of the theory of rent-seeking is associated with Tullock (1967), Stigler (1957), and Krueger (1974). A good collection of papers is by Buchanan, Tollison, and Tullock (1980). See also Bhagwati (1982), Hartle (1983) and Tollison (1982).
5. The classic pieces of work on social choice are Condorcet (1785), who first demonstrated the paradox of voting, and Arrow (1951), who showed the general impossibility of social choice rules embodying a small and apparently innocuous set of properties. Other important contributions include Downs (1957) who first considered "vote-trading" or "log-rolling" and Buchanan and Tullock (1962). An insightful early piece of analysis is Bentley (1907). Good modern texts are Sen (1970) and Feldman (1980). See also Breton (1974).
6. The reason that Canada cannot exact seigniorage just by running the printing press is that rapid monetary expansion would lead to currency depreciation. The shrinking domestic value of each dollar would be reflected in a falling value in international markets.
7. Standard references on optimum currency areas are Mundell (1961) and McKinnon (1963).
8. The idea that people might move in response to differences in transfer payments is well established in economics, although the empirical evidence in Canada is mixed, at least as far as provincial migration is concerned. See Winer and Gauthier (1983).
9. It is, of course, possible that several jurisdictions could jointly contract out the provision of some public service to a single enterprise or agency. The CBC, for example, could be funded by contributions from provinces, just as the International Monetary Fund is funded and governed by member countries. Such an agency does, however, take on aspects of a central coordinating government.

10. See Boadway and Norrie (1980) for a discussion of related issues.
11. See Buchanan and Goetz (1972), Flatters, Henderson and Mieszkowski (1974), and Starrett (1980), among others.
12. This is related to the "theory of clubs" associated with Buchanan (1965).
13. Use of investment in capital by an incumbent to establish commitments in imperfectly competitive markets is analyzed by, among others, Spence (1979), Eaton and Lipsey (1980) and Dixit (1980).
14. This issue of bidding away rents is, from the international point of view, mainly a matter of distribution. Benefits are simply transferred from Canadian taxpayers to foreign shareholders. From the purely national point of view, however, tax competition is inefficient in the sense that the total size of the pie to be divided among national claimants is reduced.
15. See also Stuart (1984).
16. See, in particular, Boadway and Flatters (1982).
17. Brennan and Buchanan (1980) use a budget size maximization model. They refer to maximization of budget size as the "Leviathan" principle.
18. See Porter (1983) and Green and Porter (1984).

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3

Unilateralism, Bilateralism and Multilateralism: *Approaches to Canadian Federalism*

KENNETH MCROBERTS

Introduction: Models, Method and History

The purpose of this essay is to explore the functioning of contemporary Canadian federalism within three basic models of intergovernmental relations:

1. unilateralism, in which each level of government acts independently of the other;
2. bilateralism, in which the federal government collaborates with provincial governments on an individual basis; and
3. multilateralism, in which the federal government acts jointly with all or most of the provincial governments. We will deal with a series of questions.

How important is each of these models within contemporary Canadian federalism? Has their relative importance grown or declined in recent years? What leads governments to choose one model over another and, thus, how can we explain these trends over time? Finally, and of most importance, how should we assess these trends? In short, what are the implications of each of these models for such concerns as the attainment of democratic ideals, the accommodation of societal diversity, and the effectiveness of policy making?

Models Defined

First, however, we need to specify more fully what is represented by each of our models. They could be defined simply in terms of the presence or absence of formal agreements among governments. This would be the easiest way to operationalize them, but it would overlook the possibility

that, while maintaining separate programs, governments nonetheless consult each other regularly to achieve complementarity. Thus, we would underestimate the degree of intergovernmental coordination. Our models will therefore include both formal federal-provincial agreements and regular consultation, usually through formally mounted consultation or liaison bodies. (There will be some difficulty in determining when consultation is sufficiently regular or serious to transcend "unilateralism.") A multilateral arrangement combines Ottawa with two or more provinces; a bilateral arrangement links it to a single province. Under unilateralism, there would be no such arrangements.

Each model allows for a variety of concrete arrangements. A multilateral program could embrace Ottawa and all of the provincial governments, as with the Canada Assistance Plan, or it could be limited to only a few provinces, as with the Rabies Indemnification Program which has the formal participation of only four provinces. The same would apply to regular consultation to coordinate independent programs.

Bilateralism could involve a unique agreement between the federal government and a single government, as with the Canada-Ontario Agreement Respecting Great Lakes Water Quality, or it could also involve agreements which the federal government negotiates with each or most of the provinces, all addressing the same general policy area but in varying ways. Examples would be agreements on regional development and immigration. One could also classify as "bilateral" those agreements, identical in form, through which the provinces subscribe to a common program. In such cases, however, the program is itself multilateral in conception; we will classify it accordingly.

Unilateralism contains several potential variants.[1] It might involve governments acting in an essentially aggressive fashion, seeking to counter each other in a "thrust/riposte" manner, but this need not be the case. Unilateralism does not necessarily imply intergovernmental struggle or policy contradiction. Governments might consult each other on an ad hoc basis, or, while not consulting each other at all, they might nonetheless take the actions of the other level of government into account and seek to make their own compatible, as in the notion of "passive partners." In another instance, one government might withdraw voluntarily from a field, giving full rein to the other level of government. Finally, unilateralism could involve governments acting without any consideration at all of the other government's behaviour, as in more "classical" notions of federalism where the separation of functions is so complete that governments can act in relative isolation of each other.

In discussing unilateralism we will tend to focus upon the first, essentially conflictual variant, but we need to bear the other possibilities in mind. In the concluding section of the essay, we will have to determine whether they can be adequate substitutes for the formal arrangements represented by multilateralism and bilateralism.

In the actual functioning of Canadian federalism these three alternatives will not always appear in pristine form. Rather, they may appear in various combinations, not only within a general area, but also even within specific programs. For instance, programs could be conceived multilaterally through extensive discussion between Ottawa and the provincial governments, yet be funded exclusively by the federal government and implemented on the basis of individual accords with the provincial governments which allow for interprovincial variation in implementation. Federal support for second language education takes essentially this form. Similarly, programs could be negotiated bilaterally then implemented on a partly unilateral basis, with each government assuming exclusive responsibility for particular portions. This, as we shall see, is the structure of the Economic Regional Development Agreements (ERDAs) now being negotiated between Ottawa and the provinces. We need also to be aware how different models may be interrelated over time. For instance, unilateral action may be only a transitory measure designed to strengthen a government's position in future negotiation of a federal-provincial agreement.

Overview of the Study

Having defined our models and noted the variety of arrangements which each of them may embrace, how will we now go about assessing their respective roles within Canadian federalism? Among the three models which we have adopted, multilateralism is probably the best known. It has been extensively documented and assessed in the existing literature. Unilateralism and bilateralism have not been so thoroughly treated. We will therefore devote most of our efforts to mapping out the roles which each of these plays.

After briefly placing the models within their historical context, we will first assess the importance of multilateralism within contemporary Canadian federalism. It will be found that in only half the cases does multilateralism in fact involve all ten provinces. Even when the matter at hand concerns all the provinces, one or more of them may decide, for a variety of reasons, not to participate. Indeed there are important areas where both of the largest provinces, Ontario and Quebec, are absent.

The next section of this essay will discuss the various forms which bilateralism has taken in recent decades. It will examine major instances of agreements between Ottawa and a single province, distinguishing instances where the subject matter directly involves only one or two provinces (as with energy pricing or offshore resource development) from instances of concern to all provinces where one province, usually Quebec, has sought distinct arrangements with the federal government. It will explore, as well, the many instances of bilateral accords with all or most provinces.

The focus will then turn to unilateralism. It will be seen that, over the years, both federal and provincial governments have acted unilaterally in areas of common concern and shared jurisdiction. But we will concentrate primarily upon the ways in which, in recent years, the federal government has substituted, or threatened to substitute, unilateralism for the collaborative procedures which it had followed in the past. In each case, we will want to locate the factors which explain why governments chose one approach, as represented by our three models, over the others. We will find that the constitutional designation of authority, whether exclusive or shared, and the incidence of a policy concern will furnish part of the answer. Such considerations will also be heavily coloured by a government's calculations as to which approach is to its strategic advantage, helping it to secure the maximum impact on a given policy sector or to maximize political credit among its citizens and so on.

The concluding sections of the essay will assess the relative advantages and disadvantages of the three models. Three primary criteria will be deployed: the attainment of democratic ideals, the accommodation of societal diversity, and the effectiveness of policy making. Different criteria favour different models. The unilateral model might well be favoured by concern with governmental accountability to legislatures and electorates, but clearly it is less likely to result in accommodation of the regional and cultural cleavages which required federalism in the first place, and it is likely to produce major contradictions and conflicts in overall policy. Moreover, we will argue, in many areas of federal concern, unilateralism simply is not a viable strategy, given provincial capacity to block unilateral initiatives. Much of our effort will be devoted to specifying the form which collaboration should take (bilateral or multilateral) in the major areas where governments have common concerns. We will assess the trade-off between intraprovincial coordination across sectors, which bilateralism allows, and sectoral coordination across provinces, which multilateralism allows. We will assess, as well, the strengths and weaknesses of asymmetrical federalism which could result both from bilateralism and some forms of multilateralism. We see it as a promising and already proven route to achieving greater accommodation of Canadian diversity.

Historical Context

Let us now briefly place the three models within their historical context. Scholars agree that prior to the Second World War, the Canadian system conformed quite closely to the unilateral model. There were few formal federal-provincial agreements, and intergovernmental consultation was rare. Federal-provincial first ministers' conferences were infrequent, restricted primarily to consideration of changes in fiscal arrangements or of changes to the British North America Act (now the Constitution Act, 1867).[2] By and large, the two levels of government functioned quite in-

dependently of each other, as the more "classical" notions of federalism had presumed. While noting Corry's finding that, by the late 1930s, federal-provincial intraction had emerged with respect to the marketing of natural products, the regulation of insurance, fisheries, conciliation in industrial disputes, and conditional grants, Donald Smiley concludes:

> More intensive research on those interactions prior to the past generation would no doubt turn up many other executive interactions, but for the most part it is reasonable to suppose that in regard to most functions federal and provincial governments carried out their respective constitutional obligations in relative isolation from one another.[3]

To underline his point, Smiley adds that it was not until 1952 that Ernest Manning and C. D. Howe had occasion to meet, even though both had held important cabinet positions since 1935!

In recent decades, the picture has changed radically so that regular consultation and formal agreement, both multilateral and bilateral, have become much more typical, characterized by "cooperative federalism" or "executive federalism." In 1983–84, there were close to 250 federal-provincial programs in operation.[4] Federal-provincial liaison bodies, drawing together federal-provincial officials, primarily bureaucratic, in a wide range of areas grew from 64 in 1957[5] to, by one estimate, 400 in 1972.[6] First ministers' conferences have become regular events, occurring at least twice a year during the 1970s.

Scholars have pointed to several factors to explain this exponential growth in federal-provincial interaction.[7] In part, it stemmed from the increased role which both federal and provincial governments over recent decades have sought to play within their respective jurisdictions. The chances were correspondingly greater that their actions would have an effect on concerns falling within the other governments' jurisdiction. To this extent at least, governments would have an interest in collaboration even if they were acting within ostensibly distinct and exclusive jurisdictions. The incentive to collaborate would be even greater in jurisdictions shared by two levels of government. Only two areas were formally concurrent in the Constitution Act of 1867 — agriculture and immigration. Subsequently, this formal concurrence was broadened to include pensions. Under the Constitution Act, however, both levels of government were given access to direct taxation. In recent decades, this has become the primary source of revenue for both governments, creating a need, not easily attained, for collaboration in taxation activities. Moreover, in the wake of the Second World War, in the name of "nationalist and egalitarian sentiments,"[8] the federal government sought, in effect, to broaden concurrency by using its spending power to involve itself in a wide range of areas which, in terms of section 92 of the Constitution Act of 1867, fell within provincial jurisdiction. In some cases, the federal government acted in a unilateral fashion, distributing funds directly to various categories

of individuals and institutions. It sought also to influence the ways in which provincial governments discharged their responsibilities — by offering them funds on a conditional basis. Finally, some of the areas with which both levels of government have concerned themselves were not explicitly listed in the Constitution Act nor has judicial interpretation of the act assigned them exclusively to a single level of government. Cases in point are communications and culture. The interpenetration of the jurisdictions and preoccupations of the two levels of government is now such that the premises of "classical" federalism no longer hold. No matter how clear the division of responsibilities, governments cannot act without reference to one another.

This need not always preclude unilateralism. In some cases, governments may conclude that the best manner in which to advance their interests is to counter and thwart the actions of the other level of government rather than collaborate with it. They may decide that the price of collaboration, in terms of reduced control over policy formulation and implementation, is such that the contradictions and duplications attendant upon unilateralism are an acceptable cost. As we shall see, such considerations recently led the federal government to reexamine critically some of the modes of collaboration which it had adopted over past decades.

Even if governments should determine that common programs and regular consultation are in their mutual interest, the issue still remains as to the form of collaboration: multilateral versus bilateral. Both forms play important roles in contemporary federalism. Of the 239 federal-provincial programs which we have identified in the Federal-Provincial Relations Office's *Federal-Provincial Programs and Activities, 1983–84*, about 100 fall within our definition of multilateral: two or more provinces are treated in a uniform manner within a common program. The rest meet our definition of bilateralism.

Multilateralism

There is a wide variety of arrangements among multilateral programs. By our estimate, about half incorporate all ten provinces. Examples would be the Canada Assistance Plan, the Hospital Insurance Program, and Assistance for the Provision of Legal Aid in Matters Relating to the Criminal Law. Among the other half, which involve a subset of provinces, a variety of conditions are present.

In some instances, these multilateral arrangements address matters which simply do not concern all ten provinces. Examples would be the Lake of the Woods Control Board (involving both Manitoba and Ontario) or the Beverly-Kaminuriak Barren-Ground Caribou Management Agreement (involving Manitoba and Saskatchewan, along with the Northwest Territories).

However, there are many cases of multilateral programs, addressing a policy concern which does affect all ten provinces, where some provinces are missing. In some cases, Quebec is the only province to be missing. For instance, Quebec is the only province not to have agreed to federal collection of its personal income tax. Typically, Quebec's non-participation has reflected concerns with provincial autonomy not shared by the other provinces. (The next section of this essay will review many cases in which Quebec's absence from multilateral agreements has been accompanied by bilateral agreement between it and the federal government.) There are, however, many instances where Quebec is not the only missing province. For example, not only Quebec, but also Ontario failed to enter agreements for federal collection of their corporate income tax and recently Alberta opted out as well. In fact, the absence of important provinces from formal federal-provincial income tax collaboration goes back to the late 1940s when the federal government first decided that it could act without the participation of the largest provinces. In 1946, when it presented its tax rental agreements to the provinces, Ottawa found that three provinces, British Columbia, Ontario and Quebec, were not satisfied with the terms offered. The six other provinces were prepared to accept them. An improvement in the offer was sufficient to secure British Columbia's approval but not that of Ontario or Quebec. Rather than continuing to try to obtain unanimous agreement, the federal government simply proceeded to enter separate but identical tax rental agreements with the now seven provinces which were prepared to accept Ottawa's terms.[9]

Another striking case of a multilateralism which excludes the largest provinces has to do with the provision of police services at the provincial level. Only eight provinces maintain contacts with the solicitor general for provision of these services by the RCMP; Ontario and Quebec maintain their own provincial police forces. In the process, the latter two provinces apparently have deprived themselves of substantial federal payments: in 1981–82, the eight participating provinces were required to reimburse the federal government for only 56 percent of the costs incurred in providing the services. (The level of reimbursement is projected to increase to 70 percent in 1990–91.)[10]

This more limited form of multilateralism also plays an important role in the constitution of formal federal-provincial liaison bodies. Van Loon and Whittington, in their analysis of the more than 400 committees listed in the 1972 *Inventory of Federal-Provincial Committees*, distinguish "omnilateral" committees (composed of all eleven governments) from "multilateral" committees (composed of the federal government and "some but not all of the provinces"). They claim that, in most policy areas, multilateral committees are more common than omnilateral ones. Apparently, the main exceptions to this are "finance, fiscal relations, and constitutional reform, where almost all of the active committees are omnilateral."[11]

In sum, "multilateralism" contains a myriad of possibilities. Only in the minority of cases are formal agreements and liaison bodies constituted of all governments. In many cases, this reflects the fact that the matter at hand does not concern all provinces. Yet, there are many important instances where this is not the case: some provinces share a function with the federal government while others discharge it themselves. In some cases, Quebec is the only non-participating province, but in key instances Quebec is joined by Ontario, which together constitute close to 60 percent of the Canadian population. Such arrangements, moreover, have persisted for a long period of time.

Nonetheless, the absence of some provinces from federal-provincial programs is not the only way in which Canadian federalism is "multi-faceted" or "asymmetrical."[12] Even when the two levels of government do collaborate, the terms of collaboration can vary widely from province to province. In many cases, this has entailed independent agreements with several or all provinces which differ markedly in their content. There are many cases in which the federal government has entered agreements with one province alone. Over the same period, the proportion of federal-provincial liaison bodies organized on a bilateral rather than multilateral basis has grown at a rapid rate. Thus, it is necessary to examine the various forms of bilateral federal-provincial collaboration and to determine why in various areas governments have chosen it over multilateralism.

Bilateralism

The increasing role of bilateralism as a mode of federal-provincial collaboration and consultation can be most clearly traced in the establishment of federal-provincial liaison bodies. Here we have reasonably reliable data spanning a period of 30 years. The trend is unmistakable.

Bilateralism in Liaison Bodies

In the early years of executive federalism, bilateral liaison bodies were relatively rare. K.W. Taylor's listing of federal-provincial committees in 1957 reveals only seven out of a total of 64 which are bilateral: two with Nova Scotia, two with Ontario, and one each with Manitoba, Saskatchewan and British Columbia. (Another 10 committees tie Ottawa to two or three provinces.) None of these bodies is at the ministerial level.[13] In a listing which Gérard Veilleux prepared for 1967, only 11 of 119 bodies, by our count, are bilateral[14] and none of these is ministerial. Yet, in an analysis of 1977 data, Veilleux found that seven of the 31 then-existing ministerial bodies were bilateral.[15] Moreover, in their analysis of a list of 482 federal-provincial bodies prepared for 1972 by the Federal-Provincial Relations Office, Van Loon and Whittington found that "far more than half are bilateral."[16] Veilleux, for his part, produced a somewhat lower

estimate of bilateral bodies on this same list: 204.[17] Bilateral bodies are found in most areas of federal-provincial relations, the main exceptions being finance, fiscal relations and constitutional reform. Prior to its demise in 1982, almost all of the committees maintained by the Department of Regional Economic Expansion (DREE) with the provinces were bilateral.[18]

Bilateralism in Consultation and Negotiation

Bilateralism is equally important in less formal federal-provincial interactions. For instance, in recent years it has played a prominent role in consultations between federal and provincial ministers. This reflects an apparent federal preference for bilateral rather than multilateral dealings. A case in point is the attempt in 1982 to substitute bilateral talks of department ministers for a multilateral first ministers' conference on the economy.[19] Prime Minister Trudeau had become disillusioned with the potential of first ministers' conferences to generate consensus on economic policy. In his view, the premiers had tended to use them simply as occasions for "fed-bashing." If, indeed, one had to meet with the provinces, better to do it on an individual basis. In the end, Trudeau did accede to the premiers' request for a multilateral conference in 1982 but was careful to label it "consultative."[20] Similarly, when preparing to impose new controls on health care funding, which clearly would not have provincial consent, Monique Bégin refused to call the meeting of all health ministers which the provinces had requested. Rather, she met with them individually, avoiding the need to face an assembled "common front."

Over the years, bilateralism has also been an important element in the negotiation of federal-provincial agreements which are themselves multilateral in form. It may simply be that bilateralism is more conducive to serious discussion, avoiding the multiplicity of issues and interests raised by the presence of all provincial governments and making the agenda more manageable. Moreover, the extensive media coverage which inevitably surrounds and, some say, undermines multilateral conferences may be avoided. Thus, the federal government may have good reason to meet with provinces individually before agreements are concluded at a subsequent multilateral conference. Further, as Van Loon and Whittington note, Ottawa may also derive a tactical advantage from a bilateral format. It may be better able to dominate the bargaining process. Moreover, "by consummating deals in several bilateral situations before going to multilateral conferences, the federal govenment may be able to "divide and conquer."[21]

Bilateralism in Formal Agreements

Nonetheless, as the data on liaison bodies suggest, bilateralism is more than simply a basis of consultation or of negotiation of multilateral

agreements. Over the last two decades bilateralism has been the basis for the negotiation, signature and implementation of numerous federal-provincial agreements. This explains the proliferation of bilateral liaison bodies since, as Van Loon and Whittington note:

> A large percentage of the bilateral committees are in fact at the operational level, and are exclusive in their composition simply because the particular program being administered involves only two governments.[22]

Bilateral agreements have taken several forms. First, there is a substantial number of federal-provincial agreements in which only one province is involved. Typically, the agreements concern matters which directly involve only one or two provinces. There is also a body of bilateral agreements between the federal government and Quebec which address matters which are of concern to all provinces but over which Quebec has sought to assume a greater responsibility than did the other provinces. Second, there are important accords which, while dealing with the same subject matter, have been negotiated independently with all or almost all of the provinces, often varying in both form and content.

Single Bilateral Accords

Accords which address matters of concern to only one or two provinces might appear to be the most straightforward form of bilateralism, but whether or not a matter is in fact of such narrow interest is often a function of the way in which it has been defined. For example, if the policy question is defined simply as one of domestic prices for oil and gas, then only the producing provinces can claim direct jurisdiction. Bilateralism between Ottawa and Alberta as the primary producing province follows quite logically. If, however, the topic is defined more generally, so that oil and gas prices become only one of many concerns (as would be the case if it were defined as energy production and conservation, let alone an industrial strategy for Canada as a whole), then multilateralism would follow quite logically. As we shall see, governments are very much aware of these more strategic considerations. They help to explain why bilateral definitions of policy concerns have prevailed in several important cases.

First, there have been bilateral agreements between Ottawa and Alberta (as well as Saskatchewan and British Columbia) regarding the pricing of oil and gas and the division of associated revenues. The most recent agreement, a five-year pact, was signed in 1981 and amended in 1983.[23] These bilateral negotiations have not always been successful. In 1980, under the National Energy Program, Ottawa imposed prices unilaterally. Moreover, other provinces have been uncomfortable with their exclusion from negotiations which, in the case of the Canadian price for oil and gas, are to have major effects upon them. In 1979, indications that the federal

government (which had despaired of securing agreement through multilateral discussions) and Alberta might have been near a bilateral agreement provoked Ontario Premier Davis to declare:

> Ontario remains firm in its position that any decision forced on Ontario prior to full and adequate discussion at the first ministers' meeting in December, as previously promised by the Prime Minister, would seriously undermine the federal-provincial cooperation necessary to solve so many of the problems facing Canada.[24]

Precisely because bilateralism deprives Ottawa of the presence of such strong allies as Ontario, Alberta has insisted that the negotiations be conducted bilaterally. Alberta's Premier Lougheed responded to Davis' declaration by noting that "there is a difference between discussion and negotiation." He would be willing to "participate in discussions" with the other provinces at a first ministers' meeting scheduled for the following month, but he would not negotiate with them.[25]

Another example related to oil and gas production is the development of offshore resources. Here, in fact, two provinces have been actively involved: Nova Scotia and Newfoundland. (Ottawa and British Columbia have been conducting much lower-profile negotiations.) Bilateralism clearly was in the federal government's interest, allowing it to settle with whichever province was more anxious to come to an agreement and then even to attempt to secure the other province on less favourable terms. Newfoundland, however, was also ready to pursue a bilateral logic, insisting that the two provincial claims were fundamentally different. Apparently, however, there was an understanding among the provinces with offshore resources as to the order in which they would deal bilaterally with the federal government.

Under a 42-year agreement signed between Ottawa and Nova Scotia in March 1982, Nova Scotia secured most of the government revenue to be generated by offshore resources (until its fiscal capacity reaches the national average of provinces), but the federal government retains ultimate control over management of the resources through both the minister of energy and its majority membership on a Canada–Nova Scotia Offshore Oil and Gas Board.[26] The question of legal ownership of the resources is to be left for court decision, but both governments agreed at the time that the accord would stand as is, whatever the court decision might be.[27] To discourage any common front of Nova Scotia with other provinces anticipating offshore production, Ottawa had proposed, as the agreement stipulates, that, if any other province should secure more advantageous arrangements, then these same terms would be applied to Nova Scotia. Nonetheless, once Nova Scotia had agreed, Ottawa then hinted broadly that, if Newfoundland did not settle soon, it would find the federal government to be much less generous. In fact, it has recently been revealed that

there were additional understandings reached with Nova Scotia which were not even publicly disclosed let alone offered to Newfoundland. A "side letter" to Nova Scotia both softened the effect of offshore oil and gas revenue on equalization payments and allowed for renegotiation of the perimeter of Sable Island.[28] In any event, Premier Peckford continued to insist that jurisdiction over offshore resources was not transferred to Canada when Newfoundland joined Confederation. Ultimately, the courts rejected this argument and awarded ownership to the federal government.

Finally, in the late 1970s, the federal Department of Industry, Trade and Commerce (ITC) was drawn into making a widely criticized bilateral initiative with Ontario. The experience demonstrated the dangers of bilateralism — at least if it is pursued in an ad hoc fashion. In effect, Ottawa found itself with two seemingly competing commitments. In the past, ITC had tended to function independently of the provinces in its efforts to stimulate industrial activity.[29] Nonetheless, in 1978 ITC established an agreement with Ontario in an ultimately successful but highly costly effort to entice Ford to establish a plant in southern Ontario. An apparatus for federal-provincial collaboration did exist in DREE's dealings with Ontario. In fact, an $86 million bid for a GM plant in Quebec had already been fashioned between DREE and the Quebec government, but the proposed Ontario site for the Ford plant did not fall within the regions designated for DREE support. However, after being approached by Ford, ITC turned to Ontario to contribute 25 percent of the $30 million solicited by Ford of Canada. (In fact, ITC Minister Jack Horner unilaterally offered the full $30 million to Ford before Ontario had agreed to pay its share.) Ultimately, the offer was raised to $68 million, to which Ontario was to contribute $28 million.[30] In the end Ford did accept the Ontario bid, but GM, for whatever reason, failed to act in Quebec. There was a strong sense in Quebec that Ottawa had once again supported Ontario over Quebec. The episode underlined the danger that bilateralism can reinforce interprovincial rivalries.

Bilateral discussions seem the logical means when the issues are defined as setting a price for oil and gas production or devising a scheme for sharing revenue from projected offshore production or attracting branch plants of North American automobile companies. They directly involve only a very few provinces. In the case of oil and gas production, one province is far and away the predominant actor. Nonetheless, a substantial number of bilateral accords have been signed with a single province, Quebec, that deal with matters of concern to all provinces. Here, bilateralism has been adopted to meet Quebec's desire to assume a greater responsibility for these matters than do the other provinces. Usually, Ottawa generalized these bilateral understandings to make them available to other provinces but, in almost all cases, no other provinces responded. During the 1950s

and 1960s, bilateralism was used extensively as a formula to reduce the direct federal role in Quebec relative to its role elsewhere.

An early case had to do with personal income tax. In 1954, after declaring that it intended to create its own personal income tax, Quebec sought to induce the federal government to allow a 15 percent abatement for its new tax rather than the 5 percent abatement designated in federal statute. In fact, Quebec proceeded to establish its own tax at the higher levels, resulting in the prospect of "double taxation" for Quebec residents. Finally, after a series of personal encounters plus correspondence and a telephone conversation with Premier Duplessis, Prime Minister St. Laurent agreed to raise the federal income tax abatement to 10 percent. Subsequently, this bilateral agreement was generalized to include the other provinces. St. Laurent told the other provinces they would be allowed to reenter the tax field under the new conditions before the five-year term had ended.[31] In its proposals for the next set of fiscal arrangements, the federal government then made this higher level of compensation available to the provinces whether they had created their own personal income tax or not.[32]

Bilateralism has also been applied to federal spending programs, substituting the government of Quebec for the federal government. In the process, it has contributed to a phenomenon that we noted earlier: multilateral programs addressing matters of concern to all provinces but lacking the participation of an important province.[33] With respect to three programs financed and administered exclusively by the federal government, Ottawa agreed that Quebec City could assume responsibility and would secure the revenue necessary to do so. In 1959, Prime Minister John Diefenbaker and Premier Paul Sauvé reached an agreement under which, in place of direct federal grants to universities (which Sauvé's predecessor, Duplessis, had forbidden in the name of provincial autonomy), Quebec would be allowed a 1 percent abatement on federal corporate income tax, and Quebec was to assume full responsibility for financing its universities. If the funds available on this basis should be less than what would otherwise have been available to Quebec universities through federal grants, then the difference would be added to equalization payments (or subtracted if the opposite were true).[34] This "contracting out" provision was extended to the other provinces in a 1960 amendment of the Federal-Provincial Tax Sharing Arrangements Act, but none of them took advantage of it.[35]

When the federal government established a youth allowance program in 1964, a comparable provincial program existed in Quebec. The Youth Allowance Act explicitly excludes provinces where the designated group is already receiving allowances prior to the coming into effect of the act. There, thanks to the Fiscal Review Act, 1964, a 3 percent abatement on

personal income tax would be made available to the provincial government.[36] Similarly, a 1964 act creating a federal program of student loans provided for contracting out, with a cash equivalent, on the part of provinces which established such a program. Once again, Quebec was the only province to take advantage of the provision.

Finally, the contracting-out principle was applied to a contributory pension scheme created in 1965. The 1965 act creating the Canada Pension Plan stipulated that provinces could exclude its application by giving notice within 30 days of the coming into force of the act of their intention to create a comparable plan that would come into effect in 1966.[37] Quebec alone took advantage of the provision. The arrangement was itself the result of a marathon of improvised bilateral negotiations between Ottawa (led by cabinet minister Maurice Sauvé, who had no formal responsibility for pensions) and the Quebec government.[38]

The contracting-out principle was also applied to cost-sharing programs. With the election of Jean Lesage in 1960, the Quebec government campaigned vigorously for extension of the precedent of university financing to federal-provincial cost-shared programs. Under the Union Nationale, the Quebec government had refused to participate in many of these programs, contending that they represented intrusions into provincial jurisdiction. Finally, in response to Quebec's demands, the Established Programs (Interim Arrangements) Act was passed in 1964. It designated a series of "standing programs" from which provinces could "contract out" by agreement with the federal government before October 31, 1965. It also listed a series of "special programs" from which provinces could withdraw well into the future.[39] Quebec was the only government to take advantage of the new procedure, opting out of all the major programs and also some minor ones.[40] Apparently, at a federal-provincial conference in 1971, Ontario formally declared its intention to "contract out" of cost-shared programs but was told by Ottawa that the option no longer existed.[41]

By the mid-1960s, then, the federal government had allowed Quebec to substitute itself in a significant number of areas where, in the rest of Canada, Ottawa continued to collaborate with the provinces or to be the sole actor. Jean Lesage claimed that, thanks to this arrangement, Quebec had indeed achieved "a statut spécial in Confederation."[42] On a bilateral basis, Ottawa had dealt with important grievances of the Quebec government. Even if the same arrangements were offered to the other provinces, the fact that none of them responded underlines the point that the arrangements had been designed to deal directly with particular concerns of Quebec. (To be sure, contracting out of spending programs was only an administrative procedure, which could be altered unilaterally by Ottawa.[43])

Nonetheless, the bilateral negotiations with Quebec which preceded these arrangements did engender some resentment among the other provinces. This was evident during the pension plan discussions and, in particular,

during negotiation of the opting-out procedure enshrined in the 1965 Interim Arrangements Act. In the latter case, the other provinces insisted on being included. Simeon concludes:

> The incident demonstrates that bilateral negotiations, while common, are often resented, and that it is difficult for any government to negotiate alone with the federal government without the nine others becoming concerned except on a purely local issue. It also shows that the other provinces are reluctant to permit "special status" for Quebec to result in a secondary status for them.[44]

More importantly, by the mid-1960s, doubts had spread within the federal government itself over the desirability of allowing Quebec to "contract out" of federal progams.[45] Prime Minister Trudeau, for his part, was resolutely opposed to any "special status" for Quebec. He pointed to the ambiguous position which Quebec MPs would have when the House deliberated on measures which would not apply to Quebec. More important was his concern that any form of "special status" for the Quebec government would reinforce Quebec nationalism and thus the prospect of Quebec secession. Hence, during the 1970s, various spending programs from which Quebec had withdrawn were eliminated or collapsed into block grants which were made without condition to all provinces. Quebec continues to maintain its own contributory pension plan, the only province to do so.

Nonetheless, Ottawa-Quebec bilateralism has persisted in a somewhat different form: consultation regarding the administration of federal programs. In 1973, after long-standing demands from Quebec for control over family allowances and most other aspects of social policy, the federal government passed legislation to allow provincial governments to determine, within certain parameters, the levels at which allowances would be distributed to different categories of recipients. Quebec has used this device to weight family allowances in favour of larger families. One other province has exploited this device — Alberta — but in pursuit of a quite different objective.[46]

In 1984, federal Minister of Employment and Immigration John Roberts signed an agreement with Jacques Léonard, Quebec minister of municipal affairs, regarding the distribution to Quebec municipalities of grants under the federal government's job creation program. Under the program, which is financed entirely by the federal government, grants for the construction of public works had been offered through Members of Parliament to municipalities in Quebec, as in other parts of Canada. The Quebec government, along with other provinces, objected to this practice contending that it intruded upon exclusive provincial jurisdiction over municipalities. But only Quebec took the additional step of threatening to penalize municipalities which accepted such grants. Bill 38, which embodied the threat, became the focus of protracted debate in the Quebec

National Assembly, but never reached final reading. Under the Roberts-Léonard agreement, Quebec municipalities desiring federal job creation grants must submit their requests to the Quebec government which in turn, forwards them to the federal Ministry of Employment and Immigration. Both governments would need to approve the application. The agreement is valid until December 31, 1985 and can be renewed by mutual consent. After the agreement had been formulated by officials of the two governments, John Roberts, the federal minister, delayed actually signing it. Apparently, there was resistance to the measure among Quebec Liberal MPs.[47] It was, in any event, a hollow victory for Quebec. After the agreement had been signed, it was learned that all funds designated for Quebec had already been committed to other projects!

Finally, a series of bilateral agreements on immigration have allowed Quebec officials to be based in Canadian immigration offices overseas and to participate directly in the selection process (in fact, to control it for one category of immigrant). No other province plays such a role. Quebec's present role in immigration grew out of a series of formal agreements dating back to 1971. In that year, the federal and Quebec governments signed an agreement (Lang-Cloutier) which allowed for "orientation officers" of the Quebec Immigration Department to be present in Canadian immigration offices overseas. Their function would be to inform and orient prospective immigrants to Quebec. They could also advise the federal officers about the merits of applicants who desired to settle in Quebec. Procedures were laid down under which the federal government would recover the costs incurred in providing space to these officers. At the same time, it was carefully stated that this Quebec presence in federal offices "n'a pas pour objet et n'aura pas pour effet de placer le Québec par rapport aux autres provinces dans une position privilégiée en matière de recrutement et de sélection des immigrants."[48]

Nonetheless, four years later, the agreement was replaced by a new one (Andras-Bienvenue) in which there was no such declaration. In fact, Quebec through its provisions would indeed appear to have assumed a special role relative to the other provinces. The Quebec "agent" (he was no longer referred to as "agent d'orientation") was to be closely involved in recruitment and selection. He could participate in joint Canada-Quebec recruitment missions. The federal officials were to provide him with full information on applicants who indicated a desire to settle in Quebec, including a copy of the application, and they were to "prendre en consideration l'avis de l'Agent de la Province." In addition, Quebec was to be consulted if employers in the province should seek the entry of temporary workers.[49]

Quebec's role was further enlarged three years later under the Cullen-Couture agreement, which is still in effect, having been renewed in February 1981. Under Cullen-Couture, selection of candidates for the status of independent immigrants who intend to settle in Quebec is

delegated to Quebec officials now dubbed "Immigration Officers." For such immigrants, formal federal approval is necessary only for other statutory concerns, such as health and security. The agreement also spells out procedures for Quebec's participation in (but not control of) selection of other categories of immigrants. Also, the agreement introduces much more detailed provisions for employers' applications for the admission of temporary workers: in effect, both the federal government and Quebec hold a veto here. Finally, it commits the two governments to consultation on areas of common interest related to immigration and demography.[50]

In the same vein as the immigration agreements, we might note an agreement which allows an employee of the Quebec Department of Intergovernmental Affairs to serve as an adviser on educational matters to the Canadian ambassador to the Ivory Coast.[51] Once again, no other province appears to have a comparable arrangement.

In effect, then, long after the federal government under Pierre Trudeau's leadership had firmly rejected the option of *statut particulier* for Quebec or any other province, it established with Quebec important bilateral agreements, especially regarding immigration, which allowed Quebec to assume administrative responsibilities which have not been assumed by other provinces. On this basis, it was possible to accommodate important concerns of the Quebec government, demonstrating in the process the adaptability of Canadian federalism. Nonetheless, in other areas, over the last ten to fifteen years, bilateral agreements have been negotiated with all or almost all of the provinces. In some cases, these agreements vary enormously in their content.

Multiple Bilateral Accords

The most important of such agreements deal with regional economic development. All provincial governments claim a concern with economic development. For its part, the federal government also has sought to play a role, with varying responses from the provinces. Multilateral negotiation and agreement is in principle a possibility here. Yet, interprovincial competition and jealousies would make exceedingly difficult the joint negotiation of a comprehensive scheme of regional development as the 1978 first ministers' meetings on the economy appear to have demonstrated.[52] Limited interprovincial structures have been established to orchestrate economic development in Atlantic Canada and in western Canada, but they have been more successful in organizing cooperation to meet specific technical problems than in addressing broader questions of regional economic development.[53] Moreover, very real differences in interest and objectives remain among regions. Beyond that, of course, the federal government may itself have a real interest in conducting federal-provincial collaboration on economic development on a bilateral basis.

If all provincial governments could indeed establish joint development schemes, as with the mid-1970s project of an interprovincial mechanism to promote the manufacture of urban transportation equipment, then Ottawa might find that its own economic role has been constrained.

In 1974, the federal Department of Regional Economic Expansion (DREE) signed comprehensive General Development Agreements (GDAs) with nine provincial governments. (A comparable agreement had already been established with Prince Edward Island.[54]) Each is a ten-year agreement intended to define comprehensive plans for regional economic development to be undertaken jointly. They all follow the same basic format, delineating the objectives or goals to be pursued, providing a developmental strategy based on an analysis of the province's social and economic conditions, and establishing guidelines for implementation.[55] Linked to each GDA are a series of subsidiary agreements which outline concrete projects. By 1981, some 117 subsidiary agreements, representing a total financial commitment of $5.4 billion, had been signed between DREE and the provinces and territories.[56]

The elaboration of the GDA and the subsidiary agreements represented bilateral collaboration at its fullest. The GDAs were negotiated between the DREE minister and a senior provincial minister. The subsidiary agreements were the outcome of priorities first set in Canada-province development committees, composed of the provincial director-general of DREE and a senior provincial government official and then pursued by provincial government officials who prepared proposals for the subsidiary agreements.[57] In addition, both types of agreement contained provisions requiring regular federal-provincial consultation. Savoie notes that the Canada–New Brunswick GDA required annual meetings of ministers and of department representatives as well as periodic program assessments. The subsidiary agreements each required a full intergovernmental exchange of information on the projects in question.[58]

As one would expect, the GDAs reflect variation in the development concerns of the provinces. Even the stated developmental objectives differ. While all nine GDAs declare improvement of long-term employment opportunities to be a primary goal, several also state concerns which are particular to the province. For instance, the Canada-Quebec GDA includes commitments to "promote increased participation of Quebecers in their own development" and "to promote balanced development of Quebec in relation to the various regions of Canada."[59] The Canada–New Brunswick agreement, unlike any other GDA, refers to the need "to raise per capita incomes while minimizing net migration from the province."[60] The Canada-Manitoba GDA adds a concern for native peoples:

> . . . to encourage socio-economic development in the northern portion of Manitoba to provide the people of the area with real options and opportunities to contribute to and participate in economic development, to continue their

> own way of life with enhanced pride and purpose and to participate in the orderly utilization of natural resources.[61]

The Canada-Saskatchewan GDA is the only one to set explicitly as an objective "to diversify the province's economic base to reduce its dependency on primary production and thereby help stabilize the provincial economy."[62]

The federal government's contribution to the cost of the joint projects also varied from province to province. In 1981, the maximum federal shares of subsidiary agreements with a province were: Newfoundland, 90 percent; Nova Scotia and New Brunswick, 80 percent; Quebec, Manitoba and Saskatchewan, 60 percent; and Ontario, Alberta and British Columbia, 50 percent.[63]

For the provincial governments, the GDAs, with their extensive collaboration between provincial and federal officials who were themselves based in the province, were a welcome change from the highly centralized and virtually unilateral approach which DREE had pursued during the 1960s. Proposals for provincial economic development had been formulated in Ottawa and then presented to the provincial governments on an essentially "take it or leave it" basis.[64] There was, to be sure, some provincial discontent with the GDAs. Quebec insisted that even this arrangement allowed Ottawa to play an illegitimate role in the formulation of economic development policy for Quebec. Among the Atlantic provinces there was also concern that federal priorities were being imposed through the GDAs, along with the fear among elected officials that control over their respective bureaucracies was being undermined by close collaboration between provincial bureaucrats and their more powerful federal counterparts.[65] But in Atlantic Canada these fears were tempered by satisfaction with the substantial federal funds which were being injected.

For their part, federal officials by the late 1970s had become disillusioned with the GDA approach, feeling that they gave the initiative to the provinces and reduced DREE to an essentially reactive role. They feared that the provincial governments were capturing most of the political credit for the projects. Thus, as we shall see in the next section, the federal government in the 1980s sought to restructure the process in order to reduce the scope of federal-provincial collaboration by allowing for direct delivery of programs.

Another area where bilateral agreements have been established with most provinces and where these agreements vary enormously in their content is in the provision of services for native peoples.[66] The federal government and Newfoundland have an agreement under which the federal government covers 90 percent of the cost of a wide range of services to native peoples in specified communities. A current agreement with Quebec (Northern Quebec Transfer Agreement) stems from the James Bay and Northern Quebec Agreement of 1975. Signed in 1981, it transfers to the

Quebec government responsibility for provision of services to the Inuit of northern Quebec, ceding existing houses and installations ($30 million in assets) in the process, and commits Ottawa to annual payments in support of the services. Ottawa and Ontario have an agreement which seeks to ensure that people living on Indian reserves have the same range of provincial services and programs as do people living in other Ontario communities. As such, it differs markedly from agreements with Manitoba, New Brunswick and Nova Scotia, which cover only certain child welfare services. Ontario also has an agreement with the federal government to assist Indian people in Northern Ontario in developing renewable natural resources. Manitoba has an agreement to cover the effects on five Indian bands of flooding caused by a hydro project, and Saskatchewan has a road construction agreement. Presumably, these high variations reflect interprovincial differences in the needs of native peoples, or at least differences in provincial governments' perceptions of these needs.

A final area in which bilateralism has resulted in highly varied relationships between the federal government and the provinces is that of immigration. Here, agreements of one kind or another have been reached with most provincial governments, but the agreements with Quebec, which are noted above, go much further than do those with the other provinces.

Upon concluding the Cullen-Couture agreement with Quebec in 1978, the federal government evidently was concerned that it might be viewed as conceding a "special status" to Quebec. Reportedly, the government sought to persuade other provinces to negotiate similar agreements. Bud Cullen, the minister, announced in the House on January 31, 1978, that negotiations were under way to this effect with five provinces.[67] Another report indicated that Alberta was the one province to show any real interest.[68] In the end, no agreement was reached with Alberta, but bilateral accords regarding the selection of immigrants have been reached with five other provinces: Nova Scotia, Newfoundland, New Brunswick, Prince Edward Island and Saskatchewan.

None of these agreements delegates the selection process to the provincial governments nor, for that matter, provides for the presence of provincial officers in Canadian immigration offices overseas. They are much more circumscribed. Most call for provincial consideration of employers' requests for admission of foreign nationals for temporary work; three call for provincial advice regarding applications for entrepreneurs, and two call for provincial approval of employment offers made to teachers, academics and doctors. Otherwise, the agreements focus upon general concerns such as levels of immigration into a province, the priorities to be pursued in processing applications, and the exchange of information on the movement of immigrants.[69] In addition, there have been several bilateral agreements regarding the settlement of refugees.[70]

Even more than the agreements regarding services to native peoples, immigration demonstrates the value of "asymmetrical federalism." Quebec

has acquired a *statut particulier* on a matter of crucial importance to its linguistic and cultural makeup, assuming responsibilities assumed by no other province, but even among the nine other provinces, asymmetry prevails. Five provinces have agreements regarding selection of immigrants; four provinces, including the largest, Ontario, do not. While one or two of these remaining provinces have been actively exploring possible federal-provincial agreements regarding the selection process, Ontario has shown no interest in doing so. Ontario and the federal government have only a minor agreement regarding settlement.

With bilateralism, then, asymmetry can emerge through interprovincial variation in the purpose and content of federal-provincial collaboration. The previous section of this essay showed how asymmetry can also emerge through multilateral arrangements with provinces choosing not to participate in programs which involve matters of clear concern to them. Also, earlier in this section, it was shown how Quebec has been able to "contract out" of important federal programs. Asymmetry, then, is an important feature of contemporary Canadian federalism to be assessed carefully in the conclusion to this study.

In sum, during the 1960s and 1970s bilateralism came to assume an increasing importance within the structures and processes of federal-provincial collaboration. Not only has it been used in informal consultations on federal and provincial policy and in preliminary stages of multilateral negotiations, but also it has led to formal mechanisms and agreements. Close to half of federal-provincial liaison bodies were bilateral by the early 1970s. Most important, during the 1960s and 1970s, in a variety of areas, agreements of many kinds were reached with the provinces on a fully bilateral basis. In some instances, these agreements have varied enormously in content and format. How might we explain the attractiveness of bilateralism in so many areas of federal-provincial collaboration?

Sources of Bilateralism

Some of the most important bilateral agreements were made with Quebec and Quebec alone. By and large, these agreements can be seen as responses to Quebec's nationalist defence of provincial autonomy; the proliferation of Canada-Quebec agreements in the 1960s and 1970s is explained in part by changes in the nature of this nationalism. Under the Duplessis regime, there had been a readiness to thwart some federal initiatives simply by forgoing the federal funds, whether through forbidding universities to accept them or by refusing to participate in cost-shared programs. With the death of Duplessis and the emergence of a state-centred neo-nationalism, more aggressive strategies were pursued in an effort to secure the funds without sacrificing the principle of provincial autonomy. Since no other provincial government shared these jurisdictional concerns,

bilateral Quebec-Ottawa arrangements were the logical route. Thus, there followed in ready succession the series of bilateral agreements through which Quebec could "opt out" of federal and federal-provincial programs. Over subsequent years, unique administrative arrangements were made with Quebec.

In a few cases, other provinces have followed Quebec's lead and made similar arrangements, but they have done so less often and with narrower policy ambitions. When tracing the forces for change in federal-provincial relations over the past 20 years, one must be careful to distinguish the demands of an increasingly assertive Quebec, with its pursuit of nationalist objectives, from a general process of "province-building" which might be attributed to all the provincial governments.[71]

Ottawa's concerns with resource development also have led it to enter into bilateral arrangements with other provinces. During the 1970s, the federal government found it necessary to enter into agreements with the oil- and gas-producing provinces. We have seen how, as it sought to maintain a domestic price for gas and oil which was well below the world price, the federal government was obliged to negotiate bilateral agreements with Alberta. As the value of offshore energy resources similarly escalated, Ottawa undertook, as well, to negotiate bilateral agreements with Nova Scotia (successfully) and Newfoundland (unsuccessfully) which would set aside the jurisdictional conflicts and allow development to proceed. We have seen how, in this instance at least, one province (Newfoundland) insisted that this question be treated bilaterally.

Finally, varying provincial needs and goals in economic development created an incentive to establish comprehensive bilateral agreements with each provincial government separately. During the 1960s, the federal government operated in a virtually unilateral fashion, presenting its own preconceived projects to the provinces on a "take it or leave it" basis. With the 1970s, however, it yielded to pressure from the provincial governments for a much more elaborate process of consultation and collaboration. In effect, the federal government was forced to recognize the important role which provincial governments necessarily play in the stimulation and orientation of regional economic development. Conceivably, this federal-provincial collaboration might have been orchestrated on a multilateral basis, but we have already noted the obstacles. In any event, the limited consultation which DREE had already undertaken in the 1960s was itself in a bilateral mode.

In some of these cases, bilateralism clearly was to the advantage of the provinces in question; negotiations on a bilateral basis were a concession on Ottawa's part. Ottawa's hand in negotiating with Alberta on oil would no doubt have been strengthened by the presence of other provinces. In the 1950s and 1960s, Quebec was able, through bilateral negotiations, to secure concessions beyond what already had been made available multilaterally. We might also see the enlargement of bilateral collaboration on

regional economic development as a victory for the provincial governments, although it has been argued that especially in the smaller provinces the elaborate federal-provincial collaboration on the GDAs not only imposed federal priorities on the provinces but had unsettling effects on the internal organization of governments.[72]

In other cases, bilateralism probably has been to the federal advantage. We have seen how the federal government drew real advantage from negotiating control of offshore resources on a bilateral rather than multilateral basis. More generally, where there is a possible interprovincial common front against a federal initiative, bilateralism may be very much to the federal advantage, allowing it to practise "divide and conquer" tactics. We saw how the federal government demonstrated this as early as 1947 when it negotiated identical tax rental schemes with seven provinces, thus circumventing the dissension of Ontario and Quebec. We have noted the role which bilateralism has played in informal bargaining prior to multilateral negotiations. And we have seen how, in recent years, the federal government has shown a penchant for consulting the provinces on a bilateral basis.

Nonetheless, the choice between bilateralism and multilateralism presupposes that governments do in fact see an advantage in collaboration. As we shall see in the next section, the federal government has in recent years developed serious reservations as to whether some of the types of collaboration in which it has been engaged are indeed in its interest. In the process, some of the multilateral and bilateral arrangements which we have been discussing have been placed in question. We need to trace this new federal interest in expanding the role of unilateral action and to assess its implications.

Unilateralism: The New Critique of Federal-Provincial Collaboration

Independent action by the two levels of government was the norm in Canadian federalism until well into this century. It was based upon a relatively clear separation of functions which meant that governments had little need to collaborate. Over recent decades the picture has changed dramatically. The wide expansion of activities by both levels of government and their common involvement in a variety of areas have engendered a proliferation of mechanisms and programs for federal-provincial collaboration, both multilateral and bilateral. Nonetheless, intergovernmental collaboration has not completely displaced unilateral action by either the federal or provincial governments. Each has continued to monopolize some functions, given both a clear constitutional mandate and the unreadiness or perhaps inability of the other level of government to get involved. For instance, the federal government continues to exercise effective control over such areas as defence, tariffs, monetary policy and diplomatic recogni-

tion. It may, on occasion, consult the provinces in discharging such functions as these, but typically it does not. Here, then, the unilateralism embodied in the "classical" conception of federalism still prevails. In other areas, a more competitive if not adversarial form of unilateralism has emerged as governments have come to involve themselves independently in areas which in the past have been the preserve of the other level of government.

Instances of federal intrusion in areas monopolized in the past by the provincial governments are well known. Classic cases are the program of direct federal grants to universities, created in 1952, and the system of family allowances, established in 1945. (In both cases, it might be noted, the federal government ultimately was constrained to respond to the objections of the provincial governments: making them the recipients of the university grants and, later, allowing their involvement in determining the distribution of family allowances.) There are now important cases of provincial intrusion as well. Since the 1960s, the Quebec government has developed a large structure of overseas offices, claiming that, for at least some purposes, it has the constitutional right to deal directly with sovereign states — a function which in the past had been effectively monopolized by the federal government. Especially in the early years, this led to a markedly adversarial form of unilateralism as Quebec sought to by-pass federal offices, contending that they had ignored Quebec's need. For its part, Ottawa vigorously challenged Quebec's right to do so, drawing upon its own relationships with foreign states to undercut Quebec's initiatives.[73] (All of this is in stark contrast to the close bilateral collaboration which we found in immigration.) More muted versions of this conflict have arisen with other provinces.[74] Whereas in the postwar years the federal government assumed the function of managing the economy through Keynesian techniques, in 1971 the Ontario government sought to counter the direction of Ottawa's efforts with its own countervailing fiscal policies.[75] Arguments have been made to justify these initiatives, drawing for instance upon a general spending power. Nevertheless, whatever their constitutional status, they have resulted in a form of "double unilateralism," with two levels of government acting independently of each other in the same policy areas.

Nonetheless, in recent years, the most striking manifestation of unilateral action has been in areas which had been marked by well-established procedures of federal-provincial collaboration. The balance of this section will focus on this phenomenon. We will examine these actions in detail and determine what factors and influences led to them. In a variety of areas where, in the past, the federal government (including previous Trudeau governments) had always secured provincial consent before acting, the Trudeau government proceeded with measures that were clearly opposed by the provinces concerned. Where once there had usually been extensive consultation prior to a move by Ottawa, the opportunity for

serious discussion simply was not provided. In still other cases, unilateral action was threatened (and given credibility through the establishment of federal task forces and study groups). In some but by no means all cases, unilateral measures were simply ploys to strengthen the federal hand in subsequent negotiation of new terms of federal-provincial collaboration. Whatever the intent, these measures contravened what appeared to have been the established norms of federal-government relations. By examining how the provincial governments responded to these forms of unilateralism and how well the provinces were able to thwart each of them, we can assess what might be the consequences if some future federal government should seriously seek to pursue unilateralism as a basic strategy.

The Critique

Upon its election to office in February 1980, the Trudeau government began to articulate three major criticisms of the established system of federal-provincial collaboration and, in the name of these criticisms, began to pursue new strategies in dealing with the provinces over a wide range of areas, including constitutional revision, regional economic development, fiscal arrangements and energy policy.

First, federal officials claimed that the existing system had allowed one or two provincial governments to block reforms and initiatives that were clearly in the common interest of all Canadians. Patriation of the Canadian Constitution was offered as a primary case in point. Over six decades, repeated attempts to find a constitutional amendment formula acceptable to all the provincial governments had failed. The Trudeau government itself had made a concerted effort to secure agreement of the provinces to a formula both through discussions of comprehensive constitutional revision, culminating in the Victoria conference, and in a series of exchanges with the provinces in the mid-1970s. For one reason or another, none of the efforts had succeeded. As a consequence, the Canadian Constitution continued to be an act of the British parliament. Moreover, in the name of federal-provincial consultation and collaboration, the provincial governments were seeking to involve themselves in federal jurisdictions, in the process undermining federal authority and legitimacy. Typically, federal officials claimed, occasions for consultation such as the first ministers' conferences were used by the provinces simply to attack federal policies, often for electoral purposes rather than to confront seriously the challenges facing the Canadian economy.

Second, federal officials became concerned that, through cooperative federalism, the provincial governments had succeeded in interposing themselves between the federal government and individual citizens. In the case of cost-shared programs, service and benefits were delivered by the provincial governments, and citizens were not made aware of the federal

contribution to their funding.[76] This became a major grievance of Ottawa against the programs it was financing through DREE under the GDAs. In fact, it was in precisely these terms that DREE Minister Pierre de Bané refused in 1981 to renew for a second five-year term a job and development program for northern Manitoba. In a Telex message to Manitoba Finance Minister Brian Ransom, de Bané declared, "The major concern with the initiative as developed is that it does not accommodate current federal concerns about federal presence and identity in program delivery."[77] DREE officials maintained that provincial governments had repeatedly failed to acknowledge publicly the federal role in GDA projects. The same kind of "visibility" concerns were raised with respect to federal transfers to the provinces for postsecondary education, health care and social assistance.

Third, it was contended that, within the existing structure of federal-provincial collaboration, federal objectives and interests were too often subordinated to those of the provincial governments. Federal officials argued that funds transferred to the provincial governments under the Established Programs Financing Act of 1977 frequently were not used in the way Ottawa had intended. The act contained no procedures to hold provincial governments accountable for their use of federal funds. In the case of universities, federal officials calculated that three provinces, Newfoundland, New Brunswick and Prince Edward Island, were not passing on to universities their full share of the grants for postsecondary education intended by Ottawa. During the operation of these arrangements, most other provinces had decreased their own support for universities.[78] Similarly, there was alarm over the extent to which, in furnishing the medical and health services to which the federal government contributed, provincial governments were tolerating the imposition of user fees and extra billing. Such measures, it was argued, seriously jeopardized the goal of full public access to health care for which the funds had been transferred to the provinces.

By the same token, the programs under the GDAs were criticized for the extent to which they were tied to the priorities of the provincial governments. Thus, in the case of the dispute with Manitoba discussed above, DREE officials claimed that their primary concern was not with "visibility" but with the type of program for northern development projects which Manitoba wanted to undertake. Rather than the resource development project which Manitoba had favoured, Ottawa preferred "human development programs."[79] (To be sure, one feature of the latter programs was that funds would be distributed directly to individuals with full federal credit.[80]) Similarly, DREE officials began to criticize the Quebec government for announcing projects before they had been given DREE approval, thereby creating such pressure that DREE had little choice but to agree. In October 1981, DREE Minister de Bané went to the extent of writing to Quebec's Minister of State for Economic Development Bernard Landry

to announce that, in the future, his ministry would reject all projects "qui aura fait l'objet d'une annonce de la part du gouvernement du Québec sans consultation et ententes préalables."[81]

Finally, in the case of energy, federal officials contended that, under the arrangements agreed to in the past, the producer provinces had steadily increased their share of petroleum production income from 27 percent in 1972 to 46 percent in 1979. (The federal share had remained at about 10 percent.) This, in turn, had led to the accumulation of large financial surpluses by the three westernmost provinces. The Alberta Heritage Saving Trust Fund held close to $10 billion in assets in 1981 and could well have in excess of $60 billion in 1990. If the provincial governments should continue to allow these funds to accumulate, it was argued, the result would be a "fiscal drag" on the Canadian economy, but if these governments should use the funds they would likely do so in ways which would lead to rapid shifts in population and economic activity which, in turn, could cause "enormous strains on the economy."[82]

New Federal Strategies

This critique of the existing structure of federal-provincial relations led the federal government to adopt dramatic new strategies in dealing with the provinces. In major areas of federal-provincial contention, including constitutional revision, regional economic development policy, fiscal arrangements and energy policy, the federal government showed a new readiness to act unilaterally without provincial acquiescence or, in the case of fiscal arrangements, without serious consultation. Proclaiming a new concern with building closer and more direct ties with Canadian citizens, the federal government began to provide benefits and services directly rather than contributing financially to their provision by the provincial governments as it had done in the past, out of respect for provincial jurisdiction. This was complemented by advertising campaigns designed not only to familiarize citizens with the services and benefits available from the federal government, but also to promote the federal position in federal-provincial disputes.

Unilateral Actions

The most dramatic instance of the new federal disposition to unilateral action was, of course, constitutional revision. Here, the provincial governments were able to undermine unilateralism. In the past, federal governments had always secured the consent of all provincial governments before forwarding to the British parliament requests for amendment to the Constitution Act, 1867 that, at least within its judgment, clearly affected the provinces. In 1971, the federal government abandoned its plans to proceed with the Victoria Charter after one government, Quebec, had

registered its dissent. Nonetheless, in 1980, after the failure of intergovernmental discussions, the federal government declared that it would proceed with a request to the British parliament to act on them. Eventually, through recourse to the courts, the eight dissenting provinces were able to constrain the federal government to secure their general (but not unanimous) consent to constitutional revision. To get this consent, the federal government had to modify its original proposals substantially. (Of course, on this basis, it did not need to secure the consent of Quebec.)

During the 1970s, Ottawa had developed the practice of negotiating bilateral agreements with Alberta (and Saskatchewan and British Columbia) on oil and gas pricing. During its short-lived term in power, the Clark government had undertaken intensive negotiations with Alberta concerning a new agreement. Agreement apparently had been reached on most of the issues, but a new deal had not yet been finalized when the Clark government was defeated in the House. The Trudeau government, for its part, led negotiations through the spring and summer of 1980 but without success. Then on October 28, 1980, the federal government proceed unilaterally to impose a pricing regime. In fact, its comprehensive National Energy Program did a great deal more than that. Through a variety of measures, it sought to change dramatically the distribution between the two levels of government of public revenue from petroleum production. Ottawa imposed the Natural Gas Export Tax and the Petroleum and Gas Revenue Tax. Through the differential structure of the Petroleum Incentive Program it threatened to shift oil and gas exploration and production to its "Canada Lands."

Ultimately, the federal government was obliged to return to the bargaining table and secure an agreement with Alberta. Alberta had responded to the National Energy Program by announcing that it would cut back production of conventional oil by 15 percent and would delay approval of two new multi-billion-dollar oil sands plants. As the months passed and the production cut came into effect in stages, the business community became increasingly uneasy with this open intergovernmental warfare. It contended that uncertainty over future oil and gas prices was stalemating economic development. The fall of the Canadian dollar was, in turn, traced to this unfavourable climate for business investment. Thus, by the summer of 1981, the pressure upon the federal government for a settlement was intense. Alberta, too, was under pressure from the petroleum industry to reach an accord.[83]

A bilateral Canada-Alberta agreement was reached on September 1. Under the agreement, the federal government increased its percentage of total industry cash flow to 26 percent (which, by some calculations, exceeded what had been envisaged under the National Energy Program). Alberta, however, secured a more rapid escalation of oil and gas prices (very similar to what it had demanded the previous summer) and the commitment of the federal government to forego but not renounce its export

tax on natural gas. Also, the Petroleum and Gas Revenue Tax was modified to make it less objectionable to Alberta. Most important, in the words of two analysts, "the province has forced the federal government to renegotiate every aspect of the so-called National Energy Program and to agree that national energy policies must involve provincial input."[84]

Fiscal arrangements were another area where the federal government adopted a more unilateral stance. In the past, the systems of fiscal transfers to the provincial governments had been developed through extensive discussions between Ottawa and the provincial governments, although no formal agreement was required. In the words of Shelagh M. Dunn, "There is a strong informal requirement that consultations be held with provincial governments, especially as the major components of fiscal arrangements represent use of the federal spending power in areas of provincial jurisdiction."[85] Nonetheless, when the Established Programs Financing (EPF) arrangements of 1977 were up for renewal, the federal government sought to change the traditional process as much as possible. The federal government presented its proposals on equalization so late (five months before the existing legislation expired) as to severely constrain federal-provincial discussion of them. It proposed to change radically the formula for determining equalization payments and to limit future increases in the payments to the rate of growth of the GNP. In addition, it proposed to eliminate a "revenue guarantee" compensation contained in the 1977 arrangements. Despite unanimous provincial opposition to its proposals, Ottawa proceeded to implement them through Bill C-97 in April 1982 (the initial proposal for change in the equalization formula was altered).[86] In the spring of 1983, under Bill C-150, Ottawa separated the cash contribution for postsecondary education from the contribution for the hospital insurance and medical care programs — once again, without provincial approval. It then imposed "six and five" restraint limits on fiscal transfers for postsecondary education.

The federal government claimed that its growing deficit precluded it from maintaining the transfers at a level which the provinces would have found satisfactory. However, some observers contend that the real reason lay elsewhere: Ottawa was determined to free up funds for more "visible" direct forms of spending. Gillespie and Maslove contend that the publicly stated concern with the deficit was "more smokescreen than substance," since, within the government's own projections, its financial requirements were to fall from $10 billion in 1980–81 to $5.5 billion in 1983–84.[87]

Whatever the underlying federal motivation, there was little that the provincial governments could do to divert Ottawa from its course. While they could complain that consultation had not been adequate, they could not point to a convention of formal consent. Nor was there any available means of obstruction or retaliation. They could, to be sure, appeal to public opinion claiming that needed services would be underfunded as a result

of the federal measures, but this seems to have had little effect. If, as Ottawa claimed, there was little public awareness of the contribution which it made to provincially delivered programs, then at least it was less likely to receive full blame for reducing its contribution.

More recently, however, the Quebec government was able to mobilize opinion against another federal measure to alter in a unilateral way existing fiscal arrangements. Bill C-3, the Canada Health Act, was designed to redefine and to enforce "national standards" in health care by penalizing provincial governments which tolerated extra billing or user fees. It was presumed that the measure would not affect Quebec; it alone had forbidden such charges. The other nine provinces vigorously protested the bill, British Columbia and Alberta threatening to take the federal government to court. Quebec protested as well, claiming that various provisions of the bill would create an undue federal intervention in provincial jurisdiction. Definition of the types of service to be covered under health insurance could be imposed unilaterally rather than be developed through federal-provincial agreement as in the past. In fact, Quebec cited parts of the stated purpose of the bill which seemed to assign Ottawa the role of planner of health services, limiting the provincial role to simple delivery. On this essentially nationalist basis, Quebec was able to mobilize considerable support culminating in the appearance before a parliamentary committee of Quebec Minister of Social Affairs Pierre-Marc Johnson in the company of 35 representatives of the major medical associations and institutions in Quebec. As a result, federal Health Minister Monique Bégin introduced several amendments to the bill which she claimed would eliminate the offending provisions.[88] Initially, observers concluded that Quebec's careful mobilization of public opinion had worked. Subsequently, however, many concluded that it had not: Quebec's concerns for provincial autonomy had not been met.[89]

Further, the federal government apparently has given serious consideration to applying the principle of direct delivery to federal spending in areas such as manpower training and postsecondary education. One proposal, which was publicly championed in 1982 by Minister of State for Economic Development Senator Bud Olson, would have eliminated the present arrangements through which the federal government contracts the provincial government to provide manpower retraining through provincial community colleges. Instead, corporations would be refunded a corporate tax levy if they provide such retraining themselves, or students themselves would be given voucher grants to cover the cost of tuition.[90] Federal officials have actively explored application of the same format to postsecondary education as well. Students might be funded if they enroll in particular programs which are seen to further federal manpower objectives, or the funds might be sent to colleges and universities for maintaining such programs. Beyond ensuring that federal funds intended for postsecon-

dary education are in fact used for that purpose and allowing even specification of the particular emphases which are to be given in that education, direct tuition grants to students or program grants to colleges and universities have obvious "visibility" benefits.[91]

Needless to say, proposals such as these have provoked strong opposition from the provincial governments. This has been especially the case with Quebec where defence of exclusive jurisdiction over education has always been a fundamental principle of provincial governments. In fact, the federal government has not proceeded with the proposals for direct grants to students. Rather, it has acted to reintroduce control over the manner in which provincial governments use the fiscal transfers intended for postsecondary education.

At the February 1982 first ministers' conference, the government had intimated that renewal of existing fiscal arrangements for postsecondary education might be contingent on the provinces allowing the secretary of state a presence in the planning of university education, so as to secure several "national objectives." Otherwise, senior officials indicated, the federal government might reduce its transfers and proceed to direct grants to students or universities.[92] The federal government did ultimately renew the arrangements without these provisions (but with "six and five" restraint limits). However, a new bill (C-12) governing aid to postsecondary education does contain a provision requiring the secretary of state to make an annual report to Parliament on the relationship between the fiscal transfers and the attainment of Canadian economic and educational objectives, along with a report on federal-provincial discussions of the national objectives of postsecondary education. The bill has been vigorously opposed by the Council of Education Ministers.[93]

At the same time, as part of its long-standing program of financial support for research, the federal government has recently made an initiative which is reminiscent of the 1950s grants to universities — with a similar response from Quebec. Early in 1984, Secretary of State Serge Joyal announced that $25 million would be made available in a special one-time program of support for university research centres. Quebec submitted a list of 16 projects, prepared in closed consultation with its universities from an original set of 60 eligible projects. However, in selecting 12 projects for Quebec, Joyal did not follow the ranking within Quebec's list. Three of the projects chosen for support did not even appear on that list. In the wake of the decision, the Conférence des recteurs et des principaux des universités du Québec (Conference of Quebec University Rectors and Principals) not only denounced the selection, but also declared that none of the money awarded to Quebec universities would be spent. Rather, it would all be held in trust until an agreement could be reached with the secretary of state over its distribution.[94] The Quebec government's protest was echoed by the Liberal opposition spokesman for education, Claude

Ryan.[95] Once again, unilateralism appears to have been frustrated.

Finally, with respect to regional economic development, the federal government has undertaken two important unilateral measures — both vis-à-vis Quebec. In May 1983, Ottawa announced a massive $224 million five-year program for the Gaspé and Lower St. Lawrence. Federal officials acknowledged that this was the first time that the federal government had proceeded on such a project without the agreement of a provincial government, but they cited difficulties in reaching an agreement with Quebec. At least this way, Finance Minister Marc Lalonde claimed, the federal government would not be subject to the will of a Quebec government minister.[96] One year later, on June 4, 1984, Minister of Economic and Regional Development Donald Johnston and Marc Lalonde announced yet another unilateral measure: $109 million for economic development in Quebec, covering communications, research, agriculture, tourism and transportation. This time federal officials pointed to difficulties in negotiating a new comprehensive bilateral development agreement: Economic and Regional Development Agreement (ERDA). According to Donald Johnston:

> We regret that the province seems to be reluctant to accept this approach [ERDA], which is based on the principle that the federal and provincial governments should be partners in planning for the economic development of the province. They seem to want to continue with the old system; from our perspective we are convinced of the need for better coordination of our respective efforts. . . .[97]

Johnston explained the decision to proceed with the unilateral expenditure in these terms:

> This delay in reaching agreement would have resulted in Quebecers not benefitting, in the short term, from funds which otherwise would have been spent in the province. This was of great concern to us and we have therefore decided to undertake certain initiatives this year.[98]

It is striking that, at the time, the federal government had not yet reached agreements with two other provinces either: Ontario and British Columbia. While Quebec may have been the only government to raise jurisdictional objections to the ERDA format, negotiations were also going badly with British Columbia, but unilateralism was not pursued there nor apparently even threatened.[99]

The unilateral expenditures for regional development in Quebec parallel two other measures which would have undercut Quebec's economic development strategy. First, Bill S-31, which was ultimately withdrawn, would have restricted provincial ownership in transportation enterprises. The measure was in fact aimed at the Quebec government's Caisse de dépôt et de placement, which had purchased 10 percent of the shares of Canadian Pacific and was requesting representation on its board. In this case,

the Quebec government apparently was able to counter the move through the mobilization of Quebec public opinion on a largely nationalist basis. Ultimately, even Quebec Liberal MPs were calling for withdrawal of the bill. At the same time, Quebec was joined by five other provincial governments: British Columbia, Alberta, Saskatchewan, Ontario and Newfoundland.[100] Second, the federal government proposed in 1981 to expropriate a right of way through Quebec territory for transmission lines to carry to U.S. markets power which had been generated in Labrador. This measure, contained in an amendment to the National Energy Board Act, has yet to be implemented.[101]

In sum, during the early 1980s the federal government acted unilaterally in a variety of areas where there had been established reasonably strong precedents for federal-provincial collaboration. The provincial governments were able to thwart federal action in most of these cases: the Constitution, the National Energy Policy, Bill S-31, direct aid to municipalities and grants to university research centres. (To be sure, in the case of the Constitution it could be argued that the final settlement was more favourable to Ottawa than it might have been without the threat of unilateralism.) The proposed hydro corridor apparently was deferred simply because it was not economically viable. In two cases, however, fiscal arrangements and the Canada Health Act, the federal government was indeed able to act despite concerted provincial opposition. And it was free to announce unilaterally two regional development programs for Quebec. In these cases, unlike the others, the federal initiatives did not necessitate the cooperation of provincial agencies nor was there strong public support for the provincial position. (We did see, however, that public opinion in Quebec, mobilized by the provincial government, forced Ottawa to clarify the overall aims of the Canada Health Act.)

More generally, one cannot help but note the role which Quebec played in these episodes. It was more vigorous than the other provinces in its resistance to some unilateral measures, most notably direct grants to municipalities and university research centres. This reflects a nationalist concern with provincial autonomy which, as we have already seen, has characterized most Quebec governments. At the same time, Quebec was a more frequent target of federal unilateralism. Several federal initiatives were focussed essentially upon Quebec: the two unilateral regional development programs, Bill S-31 and the hydro corridor. This, in turn, underlines the role which concern with Quebec played in stimulating the federal government's resort to unilateralism — a theme to which we will return.

Direct Provision of Benefits and Services

The emphasis upon direct federal relations with citizens, rather than upon collaboration with provincial governments, in areas of clear provincial

jurisdiction is perhaps most clearly demonstrated in a new disposition to deal directly with municipal governments. In 1978, the federal government had recognized the provincial demand that it should not be directly involved in the administration of grants to municipalities. Under the Community Services Grant Program, funds would be allocated to the provincial governments on the basis of population and municipal tax capacity. These would then set their own priorities in consultation with the municipalities as to where the money would be spent. (The cheques would be sent to the municipalities by the provincial governments, but the federal government would be given full public credit for the funds.[102]) Nonetheless, two and a half years later, Ottawa announced, without any consultation, that the program would be terminated in 1981 — to the consternation of among others, the Quebec government, which viewed the program as a model for channelling federal funds to the municipalities.[103] Under a new Employment Expansion and Development Program agreement signed between Ottawa and Quebec in December 1982, $50 million in municipal projects were to be jointly funded and managed by the two governments. In March 1983, however, two Quebec ministers alleged that Ottawa was seeking to manage the municipal projects itself, in particular, wanting to verify the use made of funds. They claimed that Quebec would withdraw from the agreement unless Ottawa changed its position. Lloyd Axworthy, minister of employment and immigration, refused.[104] In addition, under a direct job creation program announced in June 1983, the Ministry of Employment and Immigration made funds available to a variety of recipients, including municipal governments. According to Quebec officials, Quebec MPs, who had discretionary power over such funds, were themselves approaching Quebec municipalities to propose specific projects.[105]

All provincial governments have denounced such programs of direct federal grants to municipalities. This was repeated in 1984 at Charlottetown at the interprovincial conference of municipal affairs ministers. However, only one province, Quebec, took the additional step of threatening to penalize municipalities for accepting such grants. Ultimately, as we saw in the foregoing section, the federal government was obliged to sign a bilateral accord with Quebec, the Roberts-Léonard agreement, requiring that applications for municipal grants should come from the provincial government. To be sure, the Quebec government incurred the deep resentment of its municipalities for threatening to penalize them. In the process, a substantial amount of federal funds may have been lost. Nonetheless, the Quebec government was in the end able to thwart this form of federal unilateralism.

The federal emphasis upon dealing directly with citizens rather than allowing the provincial governments to act as intermediaries can also be clearly seen in a massive reorganization of federal activities regarding regional economic development. On January 12, 1982, the prime minister

announced that DREE would be merged with the domestic responsibilities of the Department of Industry, Trade and Commerce into a new Department of Regional Industrial Expansion (DRIE). Ultimate responsibility for the elaboration of regional development policy would now lie with a cabinet committee on economic and regional development, which would in turn be supported by a central agency, the Ministry of State for Economic and Regional Development (MSERD). MSERD was to coordinate the negotiation of "new and simpler sets of agreements with the provinces involving a wider range of federal departments."[106] Subsequently, the new agreements were designated Economic and Regional Development Agreements (ERDAs). Within these ERDAs, a central feature was to be "parallel delivery" under which some projects would be designated for provincial delivery and others for federal delivery. (There was also to be the possibility of "joint delivery" and "third-party delivery.") Through such a system of "parallel delivery," the provincial governments would no longer be able to claim all the credit for projects, even though Ottawa had made a substantial financial contribution to them.[107]

To provide MSERD with the capacity to formulate development strategies which would meet regional needs and to coordinate the conception and delivery of specific projets by the federal line departments, the office of Federal Economic Development Coordinator (FEDC) was established in each region. The FEDC was given the mandate to "provide direct and convenient access to the federal government, to ensure coordination of federal departments on the ground, and to give cabinet direct and immediate access to information on regional needs and opportunities."[108] To do this, the FEDC was given a mandate to deal not only with officials of the provincial governments, but also with various non-governmental institutions and interest groups. No longer, then, would the federal government simply be responding to proposals developed by the provinces.

The provincial governments were at first quite suspicious of the new arrangements. There was concern that, with the elimination of a line department responsible exclusively for regional development, this area would decline as a priority for the federal government. There was also concern in some quarters that, through the new federal-level structures for formulating development policy, the federal government was in effect preparing itself to do an "end run" around the provincial governments. In the case of Quebec, at least, this seemed to be confirmed by the unilateral announcement of the Gaspé and Lower St. Lawrence project, along with statements (as in January 1984) by Minister of State for Economic and Regional Development Donald Johnston that, thanks to the new regional structures, the federal government had "a very good idea of the priorities of the provinces," even without formal consultation with them.[109] In addition, there was, for the federal government, apparent difficulty in forging proposals for ERDAs, given the need to draw upon the many line departments.

Nonetheless, as of August 1984, ERDAs had been signed with seven provincial governments. In the case of one of the outstanding provinces, Ontario, agreement on a new ERDA appeared to be within grasp. There may have been more serious difficulties with British Columbia. In the case of Quebec the obstacles to an ERDA were very profound. As in other instances that we have examined, Quebec has been rigorous in its defence of provincial autonomy. For Quebec, the federal government was using the ERDA format to inject itself into matters of exclusive provincial jurisdiction, not only through direct delivery, but also through involvement in policy planning and formulation. Quebec had, in fact, staked out its position soon after the scheme was announced. In January 1982, it claimed that the federal government was seeking "to justify its direct intervention in all sectors . . . while disregarding provincial jurisdiction." In the process, the provinces were to be reduced to "simple federal agencies." In an evocation of the GDA format, Quebec declared:

> This "short-circuiting" of Quebec, or this administrative supervision by the federal government, whatever you wish to call it, will never be tolerated by Quebec. If, in this aging regime, Ottawa has lost sight of the fundamental principles of the federalism of yesteryear . . . and if the foundation of cooperative or viable federalism, which led to a general agreement in 1974 and to a series of subsidiary agreements is completely non-existent among our federal friends, then Quebec has only one option: to demand amounts that it is entitled to for this purpose in the form of fiscal transfers or unconditional financial transfers.[110]

In effect, then, if the GDA format was not to be maintained, Quebec was demanding a return to the "contracting out" arrangements of the 1960s. When federal and provincial officials met in March 1984 to negotiate an ERDA, their discussions ended in total disagreement.[111]

Finally, the new federal preoccupation with establishing direct links with citizens, in effect by-passing the provincial governments, can also be seen in a variety of massive advertising campaigns which the federal government has orchestrated in recent years. Over the 1972–82 period federal expenditures on advertising increased fourfold (faster than all but two private advertisers).[112] In 1982, the federal government was the second largest advertiser in Canada (the first, if one includes Crown corporations).[113] Secretary of State Gerald Regan clearly linked this advertising effort to the visibility concerns of the federal government when he declared in 1981:

> I cannot overstate the importance of good communication by the federal government as fundamental to the survival of a strong Canada. Put starkly, unless Canadians know the worth of national government, they will not care enough to continue to have a national government.[114]

In fact, Ottawa went beyond "informational" advertising to "advocacy" advertising, which seeks to win citizens over to the federal position in its

struggles with the provincial governments. In their study of federal advertising activities, Stanbury et al., contend that these campaigns were "the single most important factor in explaining the sharp increases in federal advertising expenditures in recent years."[115] They note that the Canadian Unity Information Office, charged with responsibility for orchestrating these efforts at public persuasion, assumed only 4.5 percent of federal advertising expenditures in 1978–79 but had reached 25.3 percent in 1980–81 and 21.1 percent in 1981–82.[116]

Sources of the New Unilateralism

This new stance on the part of the federal government might be explained in several ways. First, there is the movement to rationalized decision-making procedures and new central agencies that marked the federal government and many of the provincial governments from the late 1960s onward. The new concern with delineating precise policy objectives and measuring the effectiveness of expenditures in achieving these objectives could have provoked some of the disaffection with cost-shared programs, especially after the reforms of 1977 which virtually eliminated any conditions upon how fiscal transfers were to be used by the provinces. Also, to the extent that new central agencies have seized power from the line departments, then the alliances between federal and provincial program officials, upon which much of the past federal-provincial collaboration has been based, will be similarly weakened. In these terms, one might then wonder why, in the mid-1970s, Ottawa had been prepared to remove conditions in the first place.

Donald Smiley has taken this line of argument one step further, contending that the rise of one particular type of central agency devoted exclusively to coordinating and managing intergovernmental affairs has had a negative effect on federal-provincial collaboration. Allegedly, officials responsible for intergovernmental affairs will place a greater premium on preserving, if not expanding, jurisdiction than they will upon expanding federal-provincial collaboration:

> The implicit and single-minded purpose of intergovernmental affairs managers at the provincial level is to safeguard and if possible to extend the range of jurisdictional autonomy, including of course the revenues that provinces have under their unshared control.[117]

It would be tempting to apply this proposition to the emergence of the Federal-Provincial Relations Office (FPRO) within the federal government. However, in a recent attempt to test Smiley's proposition with respect to both the FPRO and its provincial counterparts, Timothy B. Woolstencroft found that during the 1970s the personnel within the FPRO were, in fact, divided as to how their agency should conceive its role. Whereas one set of officials did indeed see the enhancement of federal power as the primary purpose of the FPRO, others saw it as one of facilitating federal-provincial

collaboration.[118] Moreover, he cites two important instances during the 1970s when the FPRO acted to promote federal-provincial collaboration: the oil-pricing confict of 1973–74 and the financial arrangements negotiations of 1976.[119]

One might also point to changes in the international political economy and Canada's place within it. These changes provided a series of rationales for new federal strategies with the provinces. It is not clear, however, that they fully explain this stance. For instance, the prolonged recession clearly placed new pressures upon federal public finances which could be readily cited as necessitating reductions in the fiscal transfers which Ottawa was to allow the provinces. But, as we have seen, it appears that the curtailment of EPF commitments had less to do with managing the deficit than with freeing up funds for other, more attractive programs through which benefits would be directly delivered by the federal government.

More compelling are arguments framed in terms of basic structural changes in the Canadian economy and consequent obligations of Ottawa to undertake aggressive new policies to respond to them. Once again, however, it is not clear whether these concerns constituted more than convenient rationales for a new assertion of federal power. For instance, it could be argued by federal officials, as indeed it was, that the movement of economic activity to western Canada, in response to the soaring world price for oil, would have important dislocative effects on the distribution of capital and labour within Canada and that, accordingly, there was a need for Ottawa (through the National Energy Program) to stimulate activity in other parts of Canada, such as the North and offshore. An equally if not more compelling explanation of federal intervention to this effect would lie in the higher levels of revenue which Ottawa could secure from activity in the "Canada Lands."[120] By the same token, the declining competitiveness of Canadian manufactured goods on the international market could be seen as necessitating federal intervention on a couple of fronts. Declining competitiveness might be traced to the fragmentation of the domestic market for Canadian products, given non-tariff barriers erected by the provinces. This could, in turn, legitimize a federal campaign against provincial economic intervention. It could also be seen as an argument for the formulation and implementation of a massive national industrial strategy, requiring a new centralization of power at the federal level. As explanations of Ottawa's new stance, these considerations are belied by the federal government's own past behaviour. According to some studies, Ottawa has itself contributed more to the erection of non-tariff barriers than have the provinces.[121] And the federal government's rapid retreat from any attempt to apply to the manufacturing sector the type of measures embodied in the National Energy Program raises questions about this commitment to a full-fledged industrial strategy for the future. In addition, of course, there is a certain contradiction between, on the one hand, seeking to free the market from all governmental restraint and,

on the other hand, advocating governmental implementation of a comprehensive industrial strategy.

The new federal stance was more than simply a response to particular problems of the Canadian economy, however serious they might be. It transcended policy concerns of any kind. In the last analysis, it reflected a concern with the nature of the Canadian political community and with the role which the federal government should play within it, however the policy concerns of the day might be defined. Prime Minister Trudeau declared in 1981 during an address in Vancouver that:

> [It was time to] reassert in our national policies that Canada is one country which must be capable of moving with unity of spirit and purpose towards shared goals. If Canada is indeed to be a nation, there must be a national will which is something more than the lowest common denominator among the desires of the provincial governments.[122]

Declaring that Ottawa had revised the fiscal arrangements in order to reserve money for new national projects, Trudeau said, "We have stopped the momentum that would have turned Canada into, in everything but name only, ten countries."[123]

It was on this basis that terms such as "community of communities" were dismissed out of hand, and it was for this reason that it became important that, in a wide variety of areas, citizens should have a direct, unmediated relationship with their "national" government.

One might view such a general assertion of federal authority as simply a response to the surge of "provincialism" which seemed to have occurred in many areas. In such a context, Ottawa's new strategies would simply be an attempt to restore balance between the two levels of government, within an ongoing federal system. However, questions have been raised as to whether indeed power and initiative have shifted to the provincial level. Certainly "province-building" has not been a uniform process across Canada.[124]

Moreover, such an analysis would miss the crucial role played by the federal government's struggles with a single provincial government — Quebec. In large part, the strategies which the federal government deployed against the provinces in the early 1980s had been forged in its struggle in the 1970s to impose a particular view of Canada and of the federal government within Quebec. In fact, the impact of this struggle upon the federal government can be traced in the rise within the FPRO of a task force under Paul Tellier to mount the federal offensive against the Parti Québécois government and in the April 1980 nomination of Michael Kirby as secretary to the cabinet for federal-provincial relations. By 1980, the FPRO finally had, as Smiley's proposition predicts, become fully committed to the enhancement of its government's authority.

The strategy of appealing directly to Canadian citizens and countering the pretensions of provincial governments to define the interests of their

populations had been well developed during the referendum campaign. There, Ottawa had questioned the very authority of the Quebec government to claim to speak on behalf of Québécois on any matter, given its *souvérainiste* option. In making its appeal for "the hearts and minds" of Québécois during the referendum campaign, the federal government had generally acted independently of even those provincial forces which were themselves seeking to secure a "No" vote in the referendum, such as the Quebec Liberal party under Claude Ryan.

Similarly, during the referendum campaign the federal government had placed great emphasis upon the services and benefits which it had bestowed upon Québécois. It tried very hard to make itself "visible." In fact, in the case of Quebec, federal concern with "visibility" has been a long-standing preoccupation. In his account of the federal government's preparations for the 1945 Dominion-provincial conference on reconstruction, R.M. Burns notes that:

> In the Quebec election Duplessis had swept back to power and St. Laurent saw in this a portent of a strong campaign to reinterpret Confederation to provincial benefit. Crerar . . . thought that in any Dominion-provincial conflict the majority of the people would support the provinces. St. Laurent pointed out that the provinces had the advantage of supplying services more directly to the people while the Dominion was responsible for heavy taxation and divisive policies such as conscription. He thought that the Dominion should have similar direct contacts with the people through programs such as family allowances.[125]

During the 1960s such a concern was, of course, only reinforced through the rise of a separatist movement in Quebec. By the 1970s concern with "visibility" had been generalized to include other provinces as well. According to Anthony Careless:

> [The] growing desire at Ottawa to secure a greater visibility of federal policies [can be seen as stemming] *in the first instance*, from the increasing strength and effectiveness of Quebec's separatist claims and, in later years, from the growing belligerency of rich provinces concerning the federal budgetary surplus and the way it was distributed in times of sluggish national expansion between fast and stagnant growth regions.[126]

Federal concerns with "visibility," however, had originated in a preoccupation with the federal presence in Quebec, and there can be no doubt that, with the election of a "separatist" government in 1976, "visibility" was once again, first and foremost a concern with Quebec.

The referendum victory gave a new credibility to these strategies. It should not be surprising that they were then applied to dealings with other provinces as well. Not only did Ottawa raise "visibility" concerns about its activities throughout Canada, whether under the EPF arrangements or through DREE's participation in the various GDAs, but also it deployed advocacy advertising techniques to win citizens to its propositions for con-

stitutional reform. In the constitutional struggle, it applied to the dissenting provincial governments the same critique that it had applied to the Quebec government, claiming that they had received no mandate to oppose the federal government's constitutional proposals. Within this logic, there was indeed no reason why the federal government should have to secure the approval of the provincial governments before sending the constitutional resolutions to the British parliament. If approval of a majority in Parliament, the only body representing all parts of Canada, were insufficient, then the proposals should be submitted to the people in a national referendum.

In short, just as during the 1960s bilateralism was developed at least in part out of an attempt to accommodate Quebec nationalism, so in the late 1970s unilateralism grew from the attempt to defeat Quebec nationalism.

Conclusions

It is now time to evaluate the relative advantages and disadvantages of each of the three "models" of federalism which have been under discussion: unilateralism, bilateralism and multilateralism. We will do so in terms of three criteria: effectiveness of policy formulation and implementation; the accommodation of underlying diversities in Canadian society (diversities which necessitated a federal system in the first place); and the attainment of such democratic ideals as parliamentary control of the executive and accountability of governments to citizens.

As we have already noted, there are some areas in which unilateralism continues to be the norm, with the federal and provincial governments acting in an essentially independent fashion. In some cases, these are areas which the federal government has been able to monopolize, thanks to a clear constitutional mandate and, perhaps, the simple unreadiness or inability of provinces to act within them. Instances would be monetary policy, defence policy, external tariffs and diplomatic recognition. Over recent decades, however, the areas of exclusive federal (or provincial) activity have declined markedly. Provinces have come to involve themselves in areas which, in the past, Ottawa had enjoyed for itself, such as direct dealings with foreign states. The federal government has come, through its spending activities, to involve itself in a wide range of areas which in the past had been left to the provincial governments: education, health care, social assistance, even municipal affairs. In fact, it is difficult to identify an area of provincial jurisdiction in which, either directly or through provincial collaboration, the federal government has not become involved.[127] Thus, in many if not most areas of contemporary government activity, the essential question is not whether the two levels of government will be involved but whether they will act unilaterally or will collaborate in one fashion or another.

To be sure, one might seek to circumvent the need to collaborate simply by restoring unilateralism to its original condition, as in classical federalism, of a single government being active within each governmental function. However, such an effort to "disentangle" Canadian federalism would seem to be doomed to failure, given both the conceptual difficulty in establishing a mutually exclusive categorization of contemporary governmental functions and the strong incentives which governments apparently have found to involve themselves in as wide a range of activities as is possible, however clearly the division of powers might be defined. It is this "double unilateralism," with two levels of government acting unilaterally in the same general policy areas, which will concern us in this concluding section.

Unilateralism vs. Collaboration

Even with common involvement of both levels of government in a wide range of areas, unilateralism might still seem, from certain perspectives, to be more advantageous than collaboration. In terms of the attainment of democratic ideals, unilateralism at least avoids a condition — executive federalism — which has been blamed for the breakdown in parliamentary control. With federal-provincial collaboration in formal agreements, it has been argued, decision-making powers have been assumed by bureaucrats and cabinet ministers, meeting in closed negotiations with their counterparts in other governments. Agreements reached among these executive officials are then simply presented to the various legislatures as faits accomplis.[128] Whether the elimination of executive federalism would in itself materially improve the prospect of parliamentary control is another matter. At the same time, accountability of governments to citizens might also be strengthened if each level of government were to maintain completely separate programs. Citizens would at least know who to credit or to blame for a specific program. Of course, they might also be confused by an increased duplication of programs within the same area — unilateralism need not imply disentanglement.

From the point of view of the federal government, unilateralism might offer a much more attractive base for making and implementing policy. The federal government can devise policies solely in terms of its own "national" objectives and can be in complete control of their implementation. Ottawa does not need to worry, as under cost-shared programs, about whether or not funds are in fact being used in terms of federal objectives. Once the federal government has formulated an initiative, it can act right away rather than undergoing the laborious and time-consuming process of securing provincial consent and participation. Direct delivery of benefits and services means that Ottawa can count on receiving full credit for them. Citizens should be more fully aware of the activities of the federal government and, perhaps, as a consequence, more likely to

identify with the Canadian political community. At a minimum, they might be more favourable to the governing party at election time. To be sure, if citizens should be unhappy with the programs, then the federal government would receive the full weight of the blame. Unhappiness could not be deflected upon the provincial governments.

Nevertheless, within areas occupied by both levels of government, unilateralism would seem to be costly for the Canadian system as a whole. Without federal-provincial collaboration, there is bound to be duplication and waste. A government that is concerned with achieving "visibility," and which initiates programs to do so, is bound to duplicate some existing programs of the other level of government. More important, there is the possibility that, without consultation and collaboration, the two levels of government will develop contradictory policies. Contradiction might come about simply through inadvertence. We saw how, in the 1980s, the federal government developed a program of direct grants to municipalities. In the process, it threatened to undermine the Quebec government's recently completed rationalization of municipal finances. However, the contradiction could also be deliberate.

From certain perspectives duplication of programs might seem quite acceptable. Through a market analogy, one might welcome the prospect of governments maintaining competing programs. Citizens dissatisfied with a program at one level of government could simply turn to an alternative program at another level. The analogy is a false one of course, since citizens cannot withdraw their payment for a program they have judged to be less satisfactory. Furthermore, it would be hard to defend the cost of program duplication if public revenues should be under the kinds of pressures that have marked recent years.

The possibility of programs actually contradicting each other might also be welcomed if concerted governmental action is feared rather than valued. A classical argument for federalism is that it creates the possibility that the excesses of one government might be checked through the actions of another. However, if government is viewed instead as an instrument for confronting and solving problems, then the prospect of governments implementing contradictory policies that cancel each other out is not very encouraging. Moreover, when Ottawa injects itself into a field in which the provinces already have built up a complex system, it may well create problems for the whole system, even if it is seeking simply to gain policy leverage in just one aspect of the system. For example, in health care, the Canada Health Act now requires certain arbitration mechanisms in provincial bargaining over doctors' fees, but the provinces will pay the cost, and the consequences, for all other aspects of wage setting in the health sector are unknown. Similarly, if Ottawa were to introduce a voucher system for students, keyed to specific fields, this would pose major problems for adjustment in the whole university system, a provincial responsibility.

Beyond this, there are a great many areas in which Ottawa has demonstrated an interest over the years where the provincial governments have an important capability, if not the primary capability. Consequently, it is only through collaboration with the provinces that Ottawa can hope to have any effect. In such cases as health care and social assistance, it has always been the provincial governments which have regulated private services and created public ones. Thus, such federal objectives as national standards of services and common access to services can be secured only through collaboration with the provincial governments, however difficult that may be. By the same token, in the case of energy policy we saw how, after unilaterally imposing a domestic price under the National Energy Program, the federal government was constrained, both by Alberta's retaliatory measures and by apprehension in the business community, to seek a pricing agreement with Alberta. Finally, it is difficult for the federal government to pursue any coherent regional economic development policy except in close collaboration with the provincial governments, given their jurisdiction over such matters as natural resources, municipalities, and intraprovincial road systems. Thus, in the early 1970s, DREE found itself constrained to move from a virtually unilateral mode, which effectively imposed agreements on the provincial governments, to the elaborate form of federal-provincial collaboration represented by the GDAs. While, more recently, the federal government did seek to alter somewhat the terms of collaboration with the ERDAs, it could not avoid collaboration itself. (Only in the case of Quebec has it acted unilaterally.) Collaboration is still highly complex, with Ottawa negotiating detailed comprehensive agreements with each of the provinces. Even with its new regionalized structures the federal government has not been able to dominate collaboration with the provinces in the way that it could in the 1960s.

In fact, in some fields provincial governments are in a position to prevent federal initiatives from being implemented at all. We saw how Quebec under Duplessis had been able to frustrate federal programs of direct grants to universities. More recently, it has apparently frustrated an attempt by the secretary of state to select university research centres for federal funding and, through the threat of Bill 38, has prevented direct federal grants to its municipalities. These recent events confirm what David M. Cameron and J. Stefan Dupré had already noted in the early 1980s:

> The legacy of the university-grants episode has severely circumscribed the application of the federal spending power to universities, municipalities, and other institutions under provincial jurisdiction. For practical purposes the scope of the federal spending power has increasingly been limited to the making of payments to individuals and to provincial governments.[129]

Finally, with respect to the accommodation of the diversity of Canadian society, unilateralism is, almost by definition, less satisfactory than federal-provincial collaboration, bilateral or multilateral. Collaboration with the

provinces at least ensures that some elements of diversity, those represented by the provincial governments, will be taken into consideration. To be sure, not all major cleavages are reflected in Canadian federalism. Class is a notorious exception. In some situations, provincial governments may be propelled more by their own interests, electoral or otherwise, than by distinct interests of their constituents. Also, through various modes of intrastate federalism, the federal government can itself secure a certain appreciation of the divergent positions of regions and language groups on the issues before it. However, the reproduction within federal institutions of the regional and linguistic diversity of Canadian society is far from perfect. Moreover, within such key institutions as the bureaucracy and even the cabinet, the opportunities for active defence of regional or linguistic interests are severely circumscribed. Collaboration between the federal and provincial governments remains and is likely to remain the superior format for producing policies able to accommodate diversity.

In sum, even in areas where both levels of government are present, unilateralism may still be preferable to federal-provincial collaboration in terms of such democratic ideals as accountability of the executive to the legislature and of the legislature to citizens, but clearly it is less likely to promote accommodation of societal diversity. While such a "double unilateralism" might promise a clearer response to each government's policy objectives, its net effect is negative for policy making and implementation in Canada as a whole. In fact, in some key areas where the federal government has sought to involve itself, the provincial presence is such that unilateralism simply is not viable. In addition, there is no real prospect of radically reversing the past trend to involvement by both levels across a wide variety of policy fields, short of a radical reduction in the role of government itself within Canadian society.

The problems attendant upon both levels of government acting unilaterally within the same policy area have stimulated interest over recent years in constitutional measures to prevent it from occurring. Typically, they have focussed upon the general spending power and upon the use of this power by the federal government. Under such schemes, the *federal* government would not be able to involve itself in areas assigned to the provinces, under section 92 of the Constitution Act, 1867, without their approval.[130] In some schemes, provinces which disapprove of a federal proposal would nonetheless be entitled to compensation if it were to be implemented in other provinces.

In principle, such a scheme would indeed discourage the kind of "double unilateralism" which we have been discussing. Presumably, if the federal government should be able to involve itself in these areas, it would be on a collaborative basis, with Ottawa at least adapting its actions to provincial concerns if not formally joining with the provinces in joint programs.

Such a measure could, however, entail a considerable increase in the need for judicial adjudication, as governments seek to determine whether

indeed a matter does clearly fall under section 92. In addition, advocates of the measure who see it as a device for protecting (if not enhancing) the position of the provinces may hesitate, if it should become clear that the price of federal approval of the necessary constitutional amendment would be that the measure restricts not only the federal spending power (in the name of section 92), but also the provincial power (perhaps in the name of section 91).

An alternative route to reducing "double unilateralism" would be to reestablish the trust and personal networks among officials at the two levels of government which would, in themselves, discourage adversarial relations among governments and create the personal basis amenable to collaboration. In effect, a "constitutional morality" might be cultivated.[131]

Given a recognition by both levels of government of the problems of "double unilateralism," what forms of collaboration should they seek to establish? As we have defined the term, "collaboration" need not entail formal agreements, let alone the mounting of joint programs. It might entail a regular consultation to secure the coordination of programs which the two levels of government carry out independently. In some instances, this may, in fact, be all that can be realistically pursued. This would be the case with federal and provincial governments' fiscal policies or with the objectives they set for themselves in public-sector labour negotiations. In other areas, more elaborate forms of collaboration are, however, possible and necessary.

This is most clearly the case in areas which are assigned to the provinces under section 92 and which have been effectively occupied by the provincial governments. In fields such as natural resources, regional economic development, health, welfare, education and municipal affairs, the involvement of the provincial governments is such that distinct federal programs, conceived and implemented on a unilateral basis, are bound to have a disruptive effect. In fact, in many of these areas, as we have seen, the role of the provincial governments is such that they can effectively block such federal initiatives. Here, federal involvement would have to be based upon formal federal-provincial agreements which clearly specify the federal role. Even then, however, one could imagine modes of collaboration which allow for an independent federal role at specific stages. For instance, as we have seen, under the ERDAs, federal and provincial governments may agree to "parallel projects," with Ottawa assuming the responsibility for implementing some projects and the province assuming responsibility for the others. Under the 1984 Roberts-Léonard agreements, applications for federal funds from Quebec municipalities must receive provincial approval before being forwarded to Ottawa but, if the federal government should decide to fund any of these projects, it can do so directly. By the same token, under the 1978 Cullen-Couture agreement, Ottawa and Quebec City assume responsibility for different stages of decision making regarding applications for immigration to Quebec. In the case of independent immi-

grants, Quebec has primary responsibility for the selection process, but the federal government retains exclusive control over the admission stage.

In sum, there are available a range of procedures for collaboration. Choice among them will vary from area to area. In terms of our three criteria of democratic ideals, accommodation of diversity and effectiveness of the policy process, one can presume that the evaluations which we derived about collaboration per se would similarly apply to the scope or degree of collaboration. Concern with democratic ideals would favour the more rudimentary forms of collaboration whereas concern with the accommodation of societal diversity would in most cases favour the more elaborate forms of collaboration. However, concern with the effectiveness of policy formulation and implementation would produce more ambiguous judgments. A preoccupation with overall policy coherence would militate in favour of elaborate collaboration, but the desire for rapid and effective response to changing situations might militate against detailed, long-term commitments. Beyond determining the *scope* of collaboration, however, governments need also to decide whether the form of collaboration should be bilateral or multilateral. What conclusions would stem from application of our three criteria here?

Bilateralism vs. Multilateralism

In assessing the relative advantages of bilateralism and multilateralism as modes of federal-provincial collaboration, we need to distinguish two forms of bilateralism: negotiation and agreement with one province alone versus parallel agreements with most, if not all, provinces.

With respect to the first type of bilateralism, negotiation and agreement with one province alone, we have noted several instances in which it has contributed to the accommodation of diversity, at least as represented through provincial governments. Bilateralism in negotiations of oil and gas pricing was essential to secure the accord of the Alberta government, which had articulated a regional interest clearly recognized by a large proportion of Albertans and western Canadians in general. There was a probably well-founded suspicion that within a multilateral format western Canadians would be less well represented. As we have seen, some consumer provinces resented these bilateral negotiations, but it is unlikely that, in the late 1970s and early 1980s, as regional conflict intensified, a multilateral forum could have secured Alberta's agreement on oil and gas pricing.

By the same token, we have seen how bilateral negotiations and bilateral accords allowed Quebec to assume responsibilities which, for one reason or another, did not interest the other provincial governments. While in most instances arrangements developed on a bilateral basis have been offered by Ottawa to the other provinces, in no case was an offer accepted. Thus, even if the arrangements were given a multilateral form, they

remained bilateral in practice, involving Ottawa and a single province. Over the years, the formula has been applied to a wide variety of areas including postsecondary education, social policy, immigration and assistance to municipal governments. To be sure, in some cases these bilateral arrangements did not involve collaboration in the normal sense: federal programs were simply transferred to the provincial level. Nonetheless, at least the disruptive effects of competing federal and provincial programs were avoided. Moreover, in such cases as immigration, family allowances and assistance to municipal governments, bilateral accords did lead to federal-provincial collaboration in the administration of programs. In the process, some important concerns of Quebec nationalists were addressed.

As for the effectiveness of policy implementation, it must be noted that this form of bilateralism can lead to the situation in which the federal government maintains a program in all parts of Canada but Quebec, where it is the provincial government which maintains the program. This is still the case with the contributory pension plan. If the two governments were to establish markedly different programs, then problems could rise in areas such as interprovincial mobility. For precisely this reason, however, differences probably would remain limited as the Canada/Quebec Pension Plan experience demonstrates.[132] Also, in terms of democratic ideals, there would be the anomaly of Members of Parliament voting on bills which, in the case of Quebec MPs, were not applicable to their constituents but, once again, the experience of the Canada/Quebec Pension Plan suggests that this need not be a major concern.[133]

Turning now to the second form of bilateralism, in which Ottawa enters into parallel agreements with most if not all of the provinces, we noted cases where the agreements have been virtually identical, differing only on certain technical matters. Here, tactical considerations appear to have led Ottawa to adopt such an approach, though in some cases the agreements have differed substantially. The clearest such case is the GDAs negotiated between DREE and each of the provinces. It is this form of parallel agreement which we need to consider at some length.

In terms of the democratic ideals of parliamentary control and of accountability to citizens, this form of bilateralism shares the same disadvantages as multilateral federal-provincial collaboration. In fact, they may be even more accentuated under bilateralism than under multilateralism. This appears to have been demonstrated by the GDA experience, especially in the Atlantic provinces. Analysis of the GDAs in the Atlantic provinces has uncovered precisely the type of concentration of power in the hands of bureaucrats, at the expense of cabinet ministers, let alone the legislative opposition, which critics of executive federalism have so regularly decried.[134] (To be sure, this pattern may not exist in *all* provinces.) By the same token, by involving the federal government in a wide range of provincial concerns, the GDAs have served to further blur any division of

responsibilities between governments and thus complicate the task of citizens in holding governments accountable for their actions. As Cameron and Dupré note about the GDAs:

> On the basis of these agreements, it has been possible for a single federal agency virtually to by-pass certain provincial Cabinets and deal with municipalities, school boards, universities and similar institutions as if they were under federal jurisdiction.[135]

At first glance, individual bilateral agreements with the provincial governments would seem to be superior to multilateralism in the accommodation of diversity, as represented by the provincial governments. In principle at least, individual agreements will better reflect variation in the priorities and concerns of each provincial government than can multilateral agreements. In another sense, however, bilateralism may be less conducive to accommodation of diversity. The bargaining power of provincial governments vis-à-vis the federal government may be weaker if they should deal with Ottawa on a one-to-one basis. This is suggested by Careless's comment that:

> Bilateralism is as much a federal refusal to extend its special arrangements made with one province to all as it is a provincial hope for a special private "deal." . . . More significant still has been the fact that Ottawa remains the center of its special or "flexible" relations with each province, affording the former exclusive knowledge of national policies and an overview of the balance between centripetal and centrifugal forces.[136]

Yet, it would seem that, in the case of the GDAs, most provincial governments were quite able to dominate the formulation of projects. It was the federal side itself which found itself limited to a largely "reactive" role. As Savoie notes:

> It is important to stress that under the GDA approach provincial line departments are the initiators of proposals while provincial central agencies, the provincial DREE offices and other federal departments review the proposals leading to the subsidiary agreement. Essentially, officials from these departments play a kind of Treasury Board role in accepting, reducing or rejecting provincial line department proposals.[137]

Federal frustration with this situation was one of the factors leading to the decision to seek a new format for federal-provincial collaboration.[138]

As for the overall effectiveness of policy making and implementation, multilateralism obviously promises a greater coordination across provinces of a given policy or policy area. If bilateralism is applied seriously, the policies which result will indeed vary from one province to another, but bilateralism does offer the prospect of coordination of policy on another basis: coordination of a range of policies within the same province or region, much more broadly, perhaps, than would be possible on a multilateral basis.

Such comprehensive coordination of federal and provincial initiatives within a province was, after all, the thrust of the GDAs of the 1970s. Each of the GDAs established broad objectives for a given province within which individual projects were then elaborated bilaterally. The substitution of a central agency, MSERD for DREE, as the federal agent and the involvement of all federal line departments in collaboration with the provincial governments, created the potential for coordination of a much broader range of programs within each province. Despite initial provincial suspicions, agreements were achieved on this basis with seven provinces, but only a detailed comparison of GDAs and ERDAs could determine whether this potential has been achieved. In addition, the opposition of Quebec to the new format demonstrated that not all provincial governments are prepared to pursue a "wide open" coordination of policies with the federal government. As we have noted, one of the dangers of comprehensive bilateral accords is that intimate federal-provincial collaboration, especially on the part of program specialists, may induce a disregard for jurisdictional boundaries. While smaller provinces may be ready to accept this consequence, or simply lack the capacity to resist it, larger provinces may not.

Asymmetrical Federalism

Before concluding our assessment of bilateralism versus multilateralism as modes of collaboration, we need to underline a phenomenon which we found present in both forms of collaboration: asymmetrical federalism. In our use of the term, asymmetrical federalism involves variation among provinces in the respective roles assumed by the federal and provincial governments. In some provinces a function may be discharged through close federal-provincial collaboration; in others it is assumed wholly by one level or another. In our survey of multilateral arrangements, we found instances where more than one province, not just Quebec, had declined to participate in joint programs with the federal government. For instance, both Ontario and Quebec provide their own provincial police force rather than contracting with the federal government for use of the RCMP. Ontario, Quebec and Alberta all maintain their own corporate income tax systems. In our survey of bilateral arrangements we found cases where the federal government had entered into agreements with one or two provinces regarding its administration within those provinces of Canada-wide programs. Quebec alone had an agreement with Ottawa regarding federal financial assistance to municipalities, and both Quebec and Alberta have set parameters for the federal government's distribution of family allowances. By the same token, the federal government had developed, through bilateral discussions with Quebec, arrangements for "contracting out" of federal and federal-provincial programs which were offered to all provinces but exploited only by Quebec. Finally, we found cases in

which the federal government had entered into agreements with several provinces which varied enormously in the roles which they assigned to the two levels of government. In the case of immigration, the federal government has an agreement with Quebec under which Quebec officials assume primary responsibility for the selection of at least one category of immigrant. While there are agreements with five other provinces regarding immigration, none of them allows such a direct provincial involvement in the selection process.

In terms of concern with democratic ideals, such asymmetry would seem to be undesirable. It is all the more difficult for voters to hold governments responsible for their actions if, in fact, the responsibilities of governments vary from province to province. Also, the overall coherence of policy may suffer, although we have seen from the case of the Canada/Quebec Pension Plan that the margin for variation between provincial and federal or federal-provincial policies may be limited. However, asymmetrical federalism would seem to be tailor-made for a political system such as Canada's in which the accommodation of societal diversity has been an endemic problem. It should not be surprising, then, that asymmetry has emerged in so many areas as governments have sought to reconcile competing objectives and concerns. The value which asymmetry assumes in these terms may well outweigh its deficiencies with respect to the two other criteria.

The Choice

In our survey of the relative merits of bilateralism and multilateralism, we found that the application of different criteria produces different assessments. In terms of accommodation of societal diversity, at least as articulated by provincial governments, bilateralism would seem to be preferable. However, concern with such democratic ideals as accountability of governments to citizens would suggest that, if collaboration should be necessary, better it be on a multilateral basis, especially if it were to embrace all governments in a common agreement. In terms of policy formulation and implementation, both forms of collaboration promise federal-provincial coordination, but on different bases: intraprovincial versus interprovincial.

In effect, then, to choose between bilateralism and multilateralism we need to choose among criteria. In particular, we need to choose between the two goals of accommodation of diversity and democratic accountability. Thus, there is no clear basis here for prescribing one mode of collaboration over another, neither generally nor within specific sectors. Nonetheless, we might be able to draw some conclusions on the basis of our third criterion, the effectiveness of the policy process. The simple geographical configuration of a policy concern may provide some clues as to whether intraprovincial coordination (bilateralism) or interprovincial coordination (multilateralism) is needed.

A clear candidate for bilateralism is the establishment of a pricing and revenue-sharing regime for oil and gas. As we have seen, these regimes have been negotiated between the federal government and the petroleum-producing provinces. Since production is so much concentrated in Alberta, it seems quite appropriate that the federal government should first negotiate a bilateral agreement with that province. Additional agreements, patterned after this one, are then established between Ottawa and each of the other two producing provinces, Saskatchewan and British Columbia.

Bilateralism may also be more appropriate for federal-provincial collaboration on economic development. Here, the matters to be addressed vary significantly from province to province. If the goal of development policy is to strengthen the position of weaker provincial economies, it would need to focus upon the specific deficiencies and missed opportunities that are experienced by each region. In doing so, it would have to draw fully upon the expertise which provincial governments have developed about their specific economies. This can only be done on a province-by-province basis, as both the GDA and ERDA schemes have recognized. At the same time, if the federal concern is with increasing Canada's international competitiveness through a comprehensive industrial strategy, then bilateralism still seems to be preferable. As Michael Jenkin has argued, not only does bilateralism allow the federal government "to tailor its policies to the needs of a specific province," it allows Ottawa to "encourage only those aspects of provincial industrial policies which are most supportive of national industrial development objectives." Thus, he suggests, the federal government would have "industrial policy instruments designed specifically for Alberta which would focus on resource-extraction technology; in Nova Scotia, by contrast, federal support might be directed to marine industries and offshore technology."[139]

Conversely, in the case of such matters as health care, social assistance and even postsecondary education, the stated objectives of federal involvement have been defined in terms which do apply uniformly to all provinces. By and large, the objectives can be reduced to one of equivalence in the level of public services available to residents of all provinces. By the same token, provincial governments, are generally concerned that they should receive their "fair share" of whatever funds are provided to support this objective. Accordingly, federal-provincial collaboration on a multilateral basis, through a single arrangement applying to all provinces, would seem to follow quite logically.

To be sure, there is always the possibility that federal objectives in such areas might be defined in such a way that, while applicable to all provinces, they are for one reason or another unacceptable to some or all provincial governments. While ostensibly seeking simply to establish interprovincial equivalence in the quality of public services, the federal government may become more involved in the very definition of the services than some provinces are ready to accept. This difficulty is clearly demonstrated in

the recent discussion of "national objectives" for postsecondary education. Over recent years the federal government has enlarged its definition of these objectives so as to include not only access to postsecondary education, but also the development of programs in Canadian studies, the promotion of a national identity, and emphasis upon training in particular skills or fields of knowledge that Ottawa deems to be important within a national industrial strategy. Clearly, such an involvement in the definition of postsecondary education will be unacceptable to most if not all provincial governments. Thus, the federal government will find itself unable to achieve its objectives through federal-provincial collaboration.

At this point, the temptation will be correspondingly greater for the federal government to act unilaterally, distributing funds directly to students and schools so as to clearly promote federal objectives. Yet, at various places in this paper we have seen the problems engendered by unilateral federal action in areas that are central to provincial jurisdiction. Ultimately, the pre-eminent role of the provinces in areas such as education limits the role which Ottawa can plan within any joint action with the provincial governments. However, as Quebec's actions over the years have demonstrated, it can also render unilateral federal action virtually inoperative.

In sum, over the last few decades Canadian federalism has undergone a profound transformation which has placed a new premium on federal-provincial collaboration and has imposed new costs on unilateralism. The clear separation of functions which "classical federalism" posited no longer exists. Nor can one realistically hope to restore it. Accordingly, unilateralism has taken on a new light. In so many areas, unilateralism is likely to mean *two* levels of government acting in ways that may well be contradictory, intentionally or otherwise, and could well be wasteful. If governments are "doomed" to collaborate in a wide range of areas, there are at least a variety of modes of collaboration available to them. They can choose to collaborate bilaterally or multilaterally. They can choose to collaborate at some stages of a program but not at others. The challenge in the coming years will be to develop new and creative modes of collaboration rather than to retreat into styles and modes of behaviour that might have been appropriate thirty years ago but which have an entirely different effect in the Canada of the 1980s.

Notes

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1. I would like to thank Peter Leslie for his discussion of these alternative forms of unilateralism.
2. See Garth Stevenson, *Unfulfilled Union: Canadian Federalism and National Unity*, rev. ed. (Toronto: Gage, 1982), p. 191.
3. Donald V. Smiley, *Canada in Question: Federalism in the Eighties*, 3d ed. (Toronto: McGraw-Hill Ryerson, 1980), p. 92.
4. Within the Federal-Provincial Relations Office's *A Descriptive Inventory of Federal-Provincial Programs and Activities in Operation During Fiscal Year 1983–84* (Ottawa: Minister of Supply and Services Canada, 1984), we have identified 239 programs involving the federal government and at least one provincial government. (We have excluded from this calculation federal programs which do not appear to involve provincial governments directly. In the process, we have excluded all joint programs maintained exclusively with Yukon or the Northwest Territories.)
5. The 1957 estimate appears in K.W. Taylor, "Coordination in Administration," in *Canadian Public Administration*, edited by J.E. Hodgetts and D.C. Corbett (Toronto: Macmillan, 1960), p. 147.
6. The 1972 estimate emerges from a list prepared by the Privy Council Office which contained 482 items. Van Loon and Whittington note that the list contains considerable duplication but that, on the other hand, there are many subcommittees which do not appear. Thus, they claim no "exact figures can be stated" and offer the estimate of "more than 400"; see Richard Van Loon and Michael S. Whittington, *The Canadian Political System: Environment, Structure and Process*, 3d ed. (Toronto: McGraw-Hill Ryerson, 1981), p. 533. Using the same methodology at different points in time, Gérard Veilleux produced the same estimate for 1957 as did Taylor, but only 158 for 1977. He acknowledges, however, that his data are incomplete and that those of the 1972 Privy Council Office list "sont plus près de la réalité"; see Gérard Veilleux, "L'évolution des mécanismes de liaison intergouvernementale," in *Confrontation and Collaboration: Intergovernmental Relations in Canada Today*, edited by Richard Simeon (Toronto: Institute of Public Administration of Canada, 1979), p. 38.
7. See Smiley, *Canada in Question*, chap. 4; Stevenson, *Unfulfilled Union*, chap. 9; and Van Loon and Whittington, *The Canadian Political System*, chap. 16.
8. Smiley, *Canada in Question*, p. 93.
9. This account is drawn from Stevenson, *Unfulfilled Union*, p. 136.
10. Federal-Provincial Relations Office, *A Descriptive Inventory*, p. 234.
11. Van Loon and Whittington, *The Canadian Political System*, p. 536.
12. The term "multi-faceted federalism" is employed by J. Stefan Dupré and his co-authors in their 1973 study. They note the RCMP contracts as one instance of this phenomenon and suggest that "multi-faceted federalism" might well be adopted on "a grander scale" in the future; see J. Stefan Dupré et al., *Federalism and Policy Development: The Case of Adult Occupational Training in Ontario* (Toronto: University of Toronto Press, 1973), p. 237.
13. Taylor, "Coordination in Administration," pp. 151–61.
14. Gérard Veilleux, *Les Relations intergouvernementales au Canada, 1867–1967: Les mécanismes de coopération* (Montreal: Les Presses de l'Université de Québec, 1971), Appendice B.

15. Veilleux, "L'évolution des mécanismes," p. 37.
16. Van Loon and Whittington, *The Canadian Political System*, p. 536.
17. Veilleux, "L'évolution des mécanismes," p. 38. Our own attempt to classify the bodies, based simply upon their formal names as reproduced by Veilleux, seemed to confirm Veilleux's estimate.
18. Van Loon and Whittington, *The Canadian Political System*, p. 536.
19. See Sheilagh M. Dunn, *The Year in Review 1982: Intergovernmental Relations in Canada* (Kingston: Queen's University, Institute of Intergovernmental Relations, 1982), p. 89.
20. The federal government's perception of the 1982 conference and the premiers' resignation to bilateral talks, given federal resistance to a new multilateral conference, are discussed in *The Gazette* (Montreal), August 12, 1983.
21. Van Loon and Whittington, *The Canadian Political System*, p. 547.
22. Ibid., p. 546.
23. *The Globe and Mail*, July 1, 1983.
24. *The Globe and Mail*, October 18, 1979.
25. *The Globe and Mail*, October 24, 1982.
26. *Chronicle-Herald* (Halifax), March 4, 1982.
27. *The Globe and Mail*, March 3, 1982.
28. The threats of reduction in the offer to Newfoundland are documented in the *Chronicle-Herald* (Halifax), March 4, 1982. The revelations about "side letters" are discussed in *The Financial Post*, June 2, 1984.
29. Allan Tupper, *Public Money in the Private Sector: Industrial Assistance Policy and Canadian Federalism* (Kingston: Queen's University, Institute of Intergovernmental Relations, 1982), pp. 15 and 19.
30. This account is based upon David Leyton-Brown, "The Mug's Game: Automotive Investment Incentives in Canada and the United States," *International Journal* 35 (1) (Winter 1979–80): 170–84.
31. Douglas G. Hartle et al., *A Separate Personal Income Tax for Ontario: An Economic Analysis* (Toronto: Ontario Economic Council, 1983), p. 69.
32. This account of the struggle over the Quebec personal income tax is drawn largely from Stevenson, *Unfulfilled Union*, pp. 137–38.
33. See the accounts in Donald V. Smiley, *Constitutional Adaptation and Canadian Federalism Since 1945*, Document 4, Royal Commission on Bilingualism and Biculturalism (Ottawa: Queen's Printer, 1970), chap. 6; and J. Stefan Dupré, "Contracting-Out: A Funny Thing Happened on the Way to the Centennial," in *Report of the Proceedings of the Eighteenth Annual Tax Conference* (Toronto: Canadian Tax Foundation, 1965), pp. 208–18.
34. Dupré, "Contracting-Out," p. 212.
35. Smiley, *Constitutional Adaptation*, p. 71.
36. Ibid., p. 75.
37. Ibid., p. 77.
38. Richard Simeon, *Federal-Provincial Diplomacy: The Making of Recent Policy in Canada* (Toronto: University of Toronto Press, 1972), pp. 56–60.
39. Smiley, *Constitutional Adaptation*, p. 74.
40. Quebec's response is discussed in Stevenson, *Unfulfilled Union*, p. 163.
41. Ontario's 1971 attempt to contract out is recounted in Claude Morin, *Le Pouvoir québécois . . . en négociation* (Montreal: Les Éditions du Boréal express, 1972), p. 41.
42. Simeon, *Federal-Provincial Diplomacy*, p. 59.
43. See the discussion of the "gains" made by Quebec through contracting out in Morin, *Le Pouvoir québécois*, pp. 33–50.
44. Simeon, *Federal-Provincial Diplomacy*, p. 143.
45. Anthony Careless contends that officials in the Department of Finance were concerned both that special status could lead to associate statehood and that "Finance staff could

not carry out truly national fiscal and economic policy under such circumstances." A.W. Johnson, Simon Reisman and Tom Kent were strong advocates of this new tougher approach with the provinces. From 1966 on, the approach was in turn articulated by Finance Minister Mitchell Sharp and his successors. Eventually, the approach was championed by Trudeau upon his succession to the prime ministership. See Anthony Careless, *Initiative and Response* (Montreal: McGill-Queen's University Press, 1977), pp. 134–88.

46. Stevenson, *Unfulfilled Union*, p. 168.
47. See accounts in *Le Devoir*, February 1, 16 and 21, 1984.
48. As reproduced in *La Presse*, October 25, 1975, p. A-5.
49. As reproduced in *La Presse*, October 28, 1975, p. A-4.
50. Governement du Québec, "Agreement between The Government of Canada and the Gouvernement du Québec with Regard to Co-operation on Immigration Matters and on the Selection of Foreign Nationals Wishing to Settle either Permanently or Temporarily in Quebec," signed February 20, 1978 (Montreal: Ministère de l'immigration, Direction des communications, 1978).
51. Federal-Provincial Relations Office, *A Descriptive Inventory*, p. 107.
52. Michael Jenkin, *The Challenge of Diversity: Industrial Policy in the Canadian Federation*; Science Council of Canada, Background Study 50 (Ottawa: Minister of Supply and Services Canada, 1983), p. 142.
53. Ibid. See also A.A. Lomas, "The Council of Maritime Premiers: Report and Evaluation after Five Years," *Canadian Public Administration* 20 (Spring 1977): 188–99; and Gerry T. Gartner, "A Review of Cooperation Among the Western Provinces," *Canadian Public Administration* 20 (Spring 1977): 174–87.
54. A monograph-length study of the GDA experience is by Donald J. Savoie, *Federal-Provincial Collaboration: The Canada–New Brunswick General Development Agreement* (Montreal: McGill–Queen's University Press, 1981). See also Donald J. Savoie, "The GDA Approach and the Bureaucratization of Provincial Governments in the Atlantic Provinces," *Canadian Public Administration* 24 (1) (Spring 1981): 116–31. Also see discussion of the GDAs in Jenkin, *The Challenge of Diversity*, pp. 134–40; and H.G. Thorburn, *Planning and the Economy: Building Federal-Provincial Consensus* (Toronto: James Lorimer, 1984), pp. 80–85.
55. Savoie, "The GDA Approach," p. 118.
56. Canada, Department of Regional Economic Expansion, *Summaries of Federal-Provincial General Development Agreements and Currently Active Subsidiary Agreements* (Ottawa: Minister of Supply and Services Canada, 1981), p. 1.
57. Savoie, "The GDA Approach," p. 119.
58. Savoie, *Federal-Provincial Collaboration*, p. 31.
59. Canada, DREE, *Summaries of Federal-Provincial General Development Agreements*, p. 83.
60. Ibid., p. 61.
61. Ibid., p. 153.
62. Ibid., p. 165.
63. Ibid., p. 1.
64. Savoie, *Federal-Provincial Collaboration*, p. 19. This period is detailed by Careless, *Initiative and Response*.
65. Savoie, "The GDA Approach."
66. This description is drawn from Federal-Provincial Relations Office, *A Descriptive Inventory*, pp. 133–41.
67. As reported in *Canadian Annual Review, 1978*, p. 79.
68. *The Globe and Mail*, January 24, 1978.
69. This analysis is based upon copies of each of the five agreements which were supplied by the federal Department of Employment and Immigration.
70. Federal-Provincial Relations Office, *A Descriptive Inventory*, pp. 46–47.

71. This point is discussed at length by Careless, *Initiative and Response*, pp. 192ff. See also R.A. Young, Philippe Faucher, and André Blais, "The Concept of Province-building: A Critique," unpublished paper.
72. Savoie, "The GDA Approach."
73. See the account of this conflict by Howard A. Leeson, "Foreign Relations and Quebec," in *Canadian Federalism: Myth or Reality?* 3d ed., edited by J. Peter Meekison (Toronto: Methuen, 1977), pp. 510–24.
74. P.R. Johannson, "Provincial International Activities," *International Journal* 33 (Spring 1984): 357–78.
75. Careless, *Initiative and Response*, p. 212.
76. Careless demonstrates how this federal concern with "visibility" influenced federal attitudes toward regional development arrangements in the late 1960s; see ibid., p. 177.
77. *The Globe and Mail*, August 10, 1981.
78. Geoffrey Stevens, "The Next Big Storm Cloud," *The Globe and Mail*, February 19, 1981, p. 6.
79. *Winnipeg Free Press*, December 19, 1981.
80. Ibid., January 12, 1982.
81. *Le Devoir*, December 31, 1981.
82. See the documentation of the federal position by Larry Pratt, "Energy: Roots of National Policy," *Studies in Political Economy* 7 (Winter 1982): 38–40.
83. *The Globe and Mail*, August 6, 1981, p. B-2.
84. Robert D. Brown and Robert B. Parsons, "Oil Pact Has Cold Comfort for Industry," *The Financial Post*, September 16, 1981, p. 9. See also James Rusk, "Oil Pact Gives Alberta Almost What It Wanted," *The Globe and Mail*, September 2, 1981, p. 8.
85. See Sheilagh M. Dunn, *The Year in Review 1981: Intergovernmental Relations in Canada* (Kingston: Queen's University, Institute of Intergovernmental Relations, 1982), pp. 111–12.
86. Our account of this debate draws upon the excellent presentation by Dunn, *The Year in Review 1982*, Chap. 6.
87. W. Irwin Gillespie and Allan M. Maslove, "Volatility and Visibility: The Federal Revenue and Expenditure Plan," in *How Ottawa Spends Your Tax Dollars, 1982*, edited by G. Bruce Doern (Toronto: James Lorimer, 1982), p. 56.
88. See *Le Devoir*, February 17 and 22, 1984.
89. Claude Ryan makes this contention in "Les paiements de transfert fédéraux," *Le Devoir*, May 25, 1984.
90. Bruce Doern attributes this position to Olson in Doern, "Spending Priorities," p. 10.
91. See the discussion of such proposals by Gillespie and Maslove, "Volatility and Visibility," p. 57. Claude Ryan contends that the federal government appears to be seriously considering direct cheques to postsecondary students; see Ryan, "Les paiements de transfert."
92. *Le Devoir*, February 5, 1982.
93. *Le Devoir*, June 6, 1984.
94. *Le Devoir*, August 24, 1984.
95. *Le Devoir*, August 22, 1984.
96. *The Globe and Mail*, May 7, 1983.
97. Government of Canada, *News Release*, June 4, 1984, p. 2.
98. Ibid., p. 3.
99. *Le Devoir*, June 5, 1984.
100. Allan Tupper, *Bill S-31 and Federalism of State Capitalism* (Kingston: Queen's University, Institute of Intergovernmental Relations, 1983), p. 24. See also Dunn, *The Year in Review 1982*, pp. 134–37.
101. See *The Globe and Mail*, June 24, 1981; and *Le Devoir*, June 26, 1981, plus the analysis by Marc Laurendeau, *La Presse*, June 27, 1981.

102. *The Globe and Mail*, May 17, 1978.
103. *The Gazette* (Montreal), March 21, 1983.
104. Ibid., March 23, 1983.
105. Ibid., March 21, 1983.
106. Office of the Prime Minister, *Press Release*, January 12, 1982, p. 4.
107. Michael Jenkin explains the new arrangements primarily in these terms: "The impetus for this change arose, it would seem, from a widespread concern within the federal government that the public perception in the regions of its economic policies was poor. Federal policy makers also felt that in areas of regional collaboration (for example, in DREE's GDAs) too much credit for federal funding and initiatives went to provincial governments." Jenkin, *The Challenge of Diversity*, p. 164. For a detailed analysis, see Peter Aucoin and Herman Bakvis, "Organizational Differentiation and Integration: The Case of Regional Economic Development Policy in Canada," paper presented to the Canadian Political Science Association, June 1983.
108. Office of the Prime Minister, *Press Release*, January 12, 1982, p. 2.
109. *Le Devoir*, January 13, 1984 (our translation).
110. Government of Quebec, *Regional Development Background Paper*, January 28, 1982, p. 2, as quoted in Dunn, *The Year in Review 1982*, p. 147.
111. *Le Devoir*, March 23, 1984.
112. W.T. Stanbury, Gerald J. Gorn, and Charlers B. Weinberg, "Federal Advertising Expenditures," in *How Ottawa Spends: The Liberals, the Opposition and Federal Priorities*, edited by G. Bruce Doern (Toronto: James Lorimer, 1983), p. 141.
113. Ibid., pp. 139–40.
114. As quoted in ibid., p. 135.
115. Ibid., p. 154.
116. Ibid., p. 145.
117. Smiley, *Canada in Question*, p. 113.
118. Timothy B. Woolstencroft, "Organizing Intergovernmental Relations," Discussion Paper 12 (Kingston: Queen's University, Institute of Intergovernmental Relations, 1982), p. 52.
119. Ibid., p. 53.
120. As Larry Pratt observes, "The PIP incentives are designed to attract capital away from provincial lands into areas under federal jurisdiction (where Ottawa can control the pace of development and *collect the rent*), to accelerate the development of commercial frontier petroleum deposits, . . . and to encourage the formation of large Canadian controlled oil companies . . . ." (Pratt, "Energy," p. 48 — our emphasis).
121. See the discussion by Thomas J. Courchene, "Analytical Perspectives on the Canadian Economic Union," in *Federalism and the Canadian Economic Union*, edited by M.J. Trebilcock et al., Ontario Economic Council Research Studies (Toronto: University of Toronto Press, 1983), pp. 51–110.
122. As quoted in Dunn, "Federalism, Constitutional Reform and the Economy: The Canadian Experience," *Publius* 13 (2): 134.
123. *The Globe and Mail*, November 25, 1981.
124. Young, Faucher, and Blais, "The Concept of Province-building."
125. R.M. Burns, *The Acceptable Mean: The Tax Rental Agreements, 1941–1962*, Financing Canadian Federation 3 (Toronto: Canadian Tax Foundation, 1980), pp. 46–47. I am indebted to Garth Stevenson for this reference.
126. Careless, *Initiative and Response*, p. 177 — our emphasis.
127. The clearest exceptions would seem to be regulatory functions, such as labour relations.
128. See, for instance, Simeon, *Federal-Provincial Diplomacy*, p. 279; and Smiley, "An Outsider's Observations of Federal-Provincial Relations among Consenting Adults," in Simeon, *Confrontation and Collaboration*, pp. 105–13.

129. David M. Cameron and J. Stefan Dupré, "The Financial Framework of Income Distribution and Social Services," in *Canada and the New Constitution: The Unfinished Agenda*, vol. 1, edited by Stanley M. Beck and Ivan Bernier (Montreal: Institute for Research on Public Policy, 1983), p. 341.
130. See Government of Canada, "Federal-Provincial Grants and the Spending Power of Parliament," working paper on the Constitution (Ottawa, 1969); and La Commission constitutionnelle du Parti libéral du Québec, *Une nouvelle fédération canadienne* (Montreal: Le Parti libéral du Québec, 1980). Under the federal scheme, conditional grants for federal-provincial programs could only come into effect if they had received the consent of a specified number of provincial legislatures. In provinces where the program had been rejected by the provincial legislature, the federal government would make "personal grants in lieu of programme grants" directly to residents. Under the Quebec Liberal party scheme, federal use of the spending power in areas of provincial competence would require two-thirds approval of a federal council, composed of representatives of the provincial governments. Provinces which do not participate in programs which have received federal council approval would receive "une compensation appropriée." There is no indication as to precisely how this compensation would be distributed.
131. Cameron and Dupré, "The Financial Framework," p. 396.
132. See Keith Banting, *The Welfare State and Canadian Federalism* (Kingston and Montreal: McGill-Queen's University Press, 1982), p. 69.
133. Ibid., p. 166.
134. See Savoie, "The GDA Approach."
135. Cameron and Dupré, "The Financial Framework," p. 376.
136. Careless, *Initiative and Response*, p. 210.
137. Savoie, "The GDA Approach," p. 119. To be sure, Savoie does argue at length that the GDAs did induce a major restructuring of provincial governments — at least the smaller ones.
138. See the discussion of federal objectives under the ERDAs in *Le Devoir*, March 23, 1984.
139. Jenkin, *Challenge of Diversity*, p. 177.

Public Enterprise and Federalism in Canada

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Thinking About Public Enterprise and Federalism

> Crown corporations may be employed as instruments of "defensive expansionism" and means of counterattacking the policies of other governments. And under certain circumstances, Crown corporations may be used to escape the rigidities of a formal division of economic power.[1]

Introduction

In recent years, public corporations (those wholly owned by one or more governments) and quasi-public corporations (those owned jointly by one or more governments and private investors) have become better understood as instruments of public policy and components of the Canadian economy. Academic and government research has deepened our appreciation of the wide variety of corporate instruments being employed by both federal and provincial governments; it has shown the rationale for their use, the implications of their employment for the role of the state in Canada, the nature of their working relationships with governments and other shareholders, their internal organization and operation, and how these corporations perform in terms of such variables as efficiency, effectiveness and accountability.[2]

Similarly, in part due to the flurry of concern provoked by the movement to constitutional reform and the development of the Charter of Rights and Freedoms, there has, over the last decade, been considerable research interest in the subjects of federalism and the economic union.

Building on a base going back to the Rowell-Sirois report of 1940, researchers have concentrated their attention on federal-provincial financial arrangements, the structures and processes of intergovernmental col-

laboration, the impact of the Charter, the politics and legality of separation, the elusive notion of interprovincial barriers to trade, and on case studies of collaborative and conflictual policy interaction.[3]

Relating Public Ownership and Federalism

Barring a few lines in the occasional academic text,[4] the rhetorical flourishes of politicians, and the closely guarded memoranda of policy advisors,[5] this paper represents the first effort of which we are aware to bring together the study of public and quasi-public corporations on the one hand, and federalism on the other. We are interested in exploring two reasonably discrete phenomena, one relating public ownership to the division of powers, and the other relating public ownership to the machinery of federal-provincial interaction.

First, we explore the "bogeyman" hypothesis that public ownership has been employed by provincial governments to by-pass, overcome, or take advantage of the formal division of powers under the Constitution. This aspect of the hypothetical relationship between federalism and government use of public enterprise raises some difficult questions. Is it the case that, whatever the "surface" rationales provided, provincial and federal governments have resorted to public ownership in an attempt to negate the efforts of another government to exercise (or *not* to exercise) its constitutionally endorsed powers to spend, regulate and tax? Put another way, have governments of either level used the instrument of public enterprise to "invade" the legitimate policy-making territory of the other governments, or to exercise influence in areas in which they themselves have few constitutionally legitimate powers? Has public ownership been used by one government to force another government to forego the use of constitutionally endorsed taxing powers?

Our investigation of the first hypothesis focusses primarily on the impact that provincial government corporate ownership has on the formal division of powers. However, we also make some observations on what the use of public ownership implies for the economic union. This is an issue worth pursuing in more detail because it raises a number of "bogeyman" questions closely connected to the subject at hand. For instance, have provincial governments used public ownership to distort or "balkanize" the economic union by manipulation of the investment policies or purchasing policies of corporations in the interest of the equity-holding province? Similarly, has the federal government employed the vehicle of public enterprise to distort the distribution of economic resources among the various regions or provinces? On an even more speculative level, has the federal government used public ownership purposefully to retard the economic growth in one province or region in order to protect the economic status of another? There is both an economic union and a federalism question here, despite the fact that we concentrate primarily on the latter.[6]

If the questions associated with the "division of powers" side of this study seem more the province of a pamphleteer than of an academic researcher, then the issues on the "mechanisms of interaction" side may be more the bailiwick of the futurist or the prophet. The second half of the paper addresses the hypothesis that joint enterprises involving the federal and relevant provincial governments (and, where appropriate, private sector participants) provide significant opportunities as flexible vehicles for cooperation between levels of government.

This statement raises a number of supplementary issues. For instance, has the joint venture established a suitable track record as a vehicle for cooperative relationships between federal and provincial governments? What advantages might the joint venture have over other mechanisms for federal-provincial interaction? Is it merely a supplement to the existing network of collaborative machinery? What effects will the employment of this mechanism have on the level of state involvement in the economy? Are there particular areas of federal-provincial interaction in which this vehicle would be appropriate? How should such a vehicle be structured?

Some Boundaries for the Discussion

Our investigation of these two hypotheses does not represent a comprehensive examination of the universe of possible relationships between public ownership and federalism within Canada. Probably the most significant boundary in this analysis results from the limitation which we place on our examination of the first hypothesis. For the most part, our analysis and case studies focus on the activities of *provincial* governments, though we do refer to the use of public ownership by the federal government at several points.

Similarly, we limit the discussion of the second hypothesis to joint corporate ventures in which the governments — at either level — are *directly* involved as owners or members at the point of creation or purchase.[7] The wider universe of joint ventures would include those in which corporations (or their subsidiaries) owned wholly or in part by the various governments are involved as shareholders or members. While such corporations serve to vastly increase the complexity of the interaction between federal and provincial governments, most of them are incidental to the purposeful development of mechanisms of coordination between the federal and provincial governments.

While we address public enterprise as an instrument of public policy to modify the practice of federalism, the relationship can also work the other way around: federalism can affect public enterprise. In their 1982 study on public corporations and public policy, Allan Tupper and G. Bruce Doern note the tendency for governments to duplicate the public enterprise experiments of other governments within the federation. They also point out a few circumstances in which the formal division of powers makes

it difficult for a government to proceed with public ownership in a specific policy area.[8] Both legislation to bar provincial government ownership of airlines and abortive legislative attempts to narrow provincial government rights to hold and vote the shares of any national transportation company represent prominent instances of the federal government's use of the division of powers to justify limits on provincial public enterprise. Even where a provincial government's "power to own" does not run afoul of the federal regulatory power, the latter may still be capable of significantly limiting the scope or intensity of the provincial enterprise's activity.[9] In the next section we will see in the Pacific Western Airlines case how federal law was amended, after the fact, to ensure that any future provincial takeovers of airlines would be subject to federal requirements and approval.

The episode brings up the further issue of whether the federal Parliament may oust or bar the entry of provincial enterprise in areas of federal jurisdiction. Within the control of a federal regulatory scheme, particularly in light of recent dicta in the Supreme Court of Canada, Parliament does have constitutional authority to act against provincial enterprises if it so chooses. However, as the federal government learned in the S-31/Caisse affair (discussed in the following section), the political price of moving to restrict provincial involvement in federally regulated sectors may be too high.

The formation and operation of virtually every significant public enterprise, regardless of its specific rationale and objectives, will have some impact on the distribution of economic resources among the various regions in the country. The movement of the maintenance facilities of Air Canada from one province to another is a typical example. However, we lack the conceptual apparatus to identify clearly a deliberate "distortion" of the economy by a government and to measure the effects of such a "distortion." In this treacherous area of investigation, one person's "distortion" is another person's "correction."[10]

Some Conceptual Issues

Examination of both our hypotheses is difficult. One problem is the paucity or softness of the relevant data. Details of events related to the uses of public corporations and quasi-public joint ventures are generally not easily accessible. Government and corporate desires for secrecy intersect here to make the life of an outside researcher difficult.

An even more significant problem is the lack of consensus among practitioners, students and the wider public concerning the status, viability and desirability of the two central building blocks of our discussion — public ownership and federalism. Both of the hypotheses being examined depend, for instance, on the idea of governments purposefully employing public or quasi-public corporations as instruments of policy either to get around

the formal division of powers or to improve the mechanisms of federal-provincial coordination. Contemporary research suggests, however, that such purposefulness is illusory.[11] The intentions of policy makers are rarely very clearly formed when they create or buy into a wholly owned or joint venture corporation. In addition, the goals that governments set for such entities are often fuzzy or mutually contradictory. In any case, the record suggests that the mechanisms of direction and control available to governments are often not sufficient to ensure that corporations do what a government or governments want them to do. These problems are severely compounded in joint venture situations where there are a number of owners.

There is an equal degree of uncertainty on the normative side. The desirability of public ownership has emerged as one of the most significant issues on the contemporary public agenda. While not directly entering this debate, this paper is rooted firmly in that tradition of Canadian political thought which argues that, for a wide variety of environmental, historical and institutional reasons, Canadian governments will continue to be major participants in the national economy and that, in the future, public ownership will remain a legitimate and significant instrument of intervention for all governments, regardless of political stripe. The two phenomena explored in this paper would be even more important in a "neo-Keynesian" Canada where governments assumed an even more aggressive role in the economy than at present. However, even if contemporary tendencies in the direction of less direct government involvement in the economy continue, historical patterns suggest that governments will continue to make use of public ownership.

It is equally difficult to pin down the concept of federalism. There is little academic agreement either about the nature of modern Canadian federalism or about the most appropriate model for the federalism of the future. Again, while this paper does not focus on the wider issues of Canadian federalism, the discussion of the use of public ownership to by-pass the division of powers lends strength to that school of thought which characterizes Canadian federalism as a complex web of overlapping jurisdictions within which the responsibilities of the two levels of government are seldom clear, and in which interdependence is a key feature. The paper does not provide much support to the view that the last twenty years has been a period of unadulterated "province building," in which the dominant feature of the federal landscape was the emergence of strong, aggressive provincial governments. The attempts of provincial governments to use public ownership to get around the formal division of powers do not appear to have been a particularly significant weapon in the arsenal of provincial aggrandizement.

On the normative side of the federalism question there is an equally spirited debate between those who favour a conflictual or competitive model of federalism and those who focus on the need for accommoda-

tion, collaboration and coordination between governments, particularly in economic matters. Our advocacy of the joint enterprise model as a flexible vehicle for economic cooperation between governments places us clearly in the latter school. In a federal system characterized by interdependence and overlapping jurisdictions, the development of joint and coordinated mechanisms for economic policy making and delivery must be a high priority.

Public Ownership and the Division of Powers

> What emerges under federalism, therefore, is not merely a war of words, but often a clash of governments, each armed with potent instruments of intervention.[12]

Introduction

In this section we explore the "bogeyman" hypothesis — that provincial governments have been using public ownership to circumvent or pervert the intentions behind the formal division of power under the Constitution. There is little doubt that the power to own is used in this manner, so the real issue is the significance of this practice for federalism. Because the formal division of powers is constructed largely in terms of the powers to regulate, spend and tax, the Fathers of Confederation simply did not foresee the capacity of the "power to own" to cut across these more traditional powers.

Our case studies of provincial government ownership focus on provincial attempts to by-pass federal powers in two areas: regulation and taxation. In the first cluster of four cases (Caisse de dépôt et placement, Pacific Western Airlines, B.C. Savings and Trust Corporation, and British Columbia Petroleum Corporation), we show how provincial governments have used public ownership to expand their economic power, whether intentionally or otherwise, so as to run afoul of the federal regulatory systems in transportation, banking, and energy. In some cases the provincial governments employ a public corporation specifically to get around the decisions of federal regulatory agencies such as the Canadian Transport Commission which, the provincial governments argue, have frustrated the economic development objectives of the provinces. In other cases, the provincial government is perceived to be violating the integrity of a federal regulatory system, en passant, as part of a wider strategy of economic development. In both types of case, a common factor is the determined use of a spectrum of policy instruments to serve wider and more independent economic development goals — goals that many argue were reserved for the national government before the early 1960s.

In the second cluster of two cases (the Newfoundland and Labrador Corporation and the provincial hydro utilities) we look at two variations on a taxation theme. In both cases, the provincial government uses a public

corporation, through the exemptions offered by the federal *Income Tax Act*, to avoid the normal exercise of the federal taxing power. While taxation appears as a consideration in the creation of other new corporations or in the maintenance of existing agencies (e.g., B.C. Petroleum Corporation, and Potash Corporation of Saskatchewan), we focus on cases in which tax planning was a primary reason for choosing the vehicle of the Crown corporation to implement provincial policies.

Federal tax policy has favoured provincial Crown corporations since the advent of income tax legislation in the 1917 *Income War Tax Act*. The present *Income Tax Act*, in section 149(1)(d), maintains the historic concession of exempting provincial and federal corporations from the act provided that 90 percent or more of their shares are owned by the Crown in right of Canada, a province or a municipality. The exemption may extend to a joint venture involving two or more qualifying governments, provided that the 90 percent ownership test is maintained.[13] According to section 27, however, the tax-exempt status does not apply to those federal Crown corporations specified in Schedule D to the *Financial Administration Act*. Air Canada and Canadian National Railways are examples of Schedule D enterprises.

The federal policy thus amounts to a tax concession for provincial Crown corporations, and the federal authorities have moved on occasion, as the Newfoundland and Labrador Corporation (Nalco) case will show, to confine the terms of the exemption where they feel that a provincial government has unfairly exploited those terms.

The exemption is not to be confused with the reciprocal tax immunity declared in section 125 of the *Constitution Act, 1867* which reads: No lands or Property belonging to Canada or any Province shall be liable to Taxation.

The unresolved question is whether this constitutional provision only prohibits a tax on property qua property of the other level of government. Under this interpretation,[14] the federal authority to set the tax concessions for provincial Crown corporations would not be impaired by the tax immunity expressed in section 125. Similarly, the provincial authority to levy income taxes against the operations of federal Crown corporations would remain unaffected since section 125 speaks to both levels of government, and judicial authority has long recognized the shared nature of the power to tax.

A more generous interpretation of the tax immunity provision, however, would restrict the power to tax, and bar either level of government from taxing the income of the other's Crown corporations. This could have serious consequences for the competitive environment of private firms and the income tax bases of the provincial and federal governments.

While this possibility of constitutional adjudication remains theoretically available,[15] our case studies proceed within the regime of established federal concessions for eligible provincial government enterprises.

As we pointed out in the preceding section, public ownership intrusions by one level of government into the jurisdictions of the other level are not limited to the provincial governments. While we stress the ownership activities of provincial governments, we do not entirely ignore parallel initiatives by the federal government. Going back to 1935 and the inception of the Central (now Canada) Mortgage and Housing Corporation, provincial governments have argued that the federal government has used its superior financial resources and the public corporate vehicle to invade provincial turf.

The most recent such "flagrant" abuse is in the area of energy and natural resources. The intensity of the federal-provincial energy conflict in the 1973–74 and 1979–81 periods, which was in part a reflection of the magnitude of the financial stakes and the pervasiveness of related issues,[16] resulted in both sides using legal swords and shields to supplement and replace the normal mechanisms of federal-provincial negotiation.[17] Public ownership was seen as a useful instrument to attempt to exercise influence where government objectives were frustrated by the constitutional powers of the other government. Through Petro-Canada, the federal government has a powerful lever to participate in areas of provincial or disputed jurisdiction.

It is extremely difficult to "prove" that Petro-Canada is being used as a federal tool. Petro-Canada wants to be seen as a competitive business, so its policy roles are low-key and are only hinted at. In addition, there is the larger issue of whether the federal government really "controls" Petro-Canada's corporate activities.[18] However, in the battle for jurisdiction over offshore resources there are indications that Petro-Canada's strong operating position was used by the federal government to attempt to manoeuvre the Newfoundland government toward accepting federal paramountcy in a management agreement. In 1977, Newfoundland promulgated its own petroleum and gas regulations and subsequently created a Crown agency, Newfoundland and Labrador Petroleum Corporation (NLPC), which was given control of the South Hibernia area.[19] In the summer of 1983, Petro-Canada, which holds the federal permit to South Hibernia, was close to negotiating a deal with the Newfoundland government to permit drilling in the area, under a contingency agreement which allowed for a Supreme Court of Canada ruling on the offshore reference to go either way: if Newfoundland won in court, the drilling program would be treated as a farm-in to NLPC lands and, if Ottawa won, the agreement would be terminated. In July 1983, the federal energy minister vetoed the agreement by unilaterally giving South Hibernia drilling rights to Petro-Canada and ordering the company to drill.[20] This particular issue was rendered academic by the November 1983 Supreme Court decision which found that the federal government had jurisdiction over the Hibernia area. However, the more general issues of control and Petro-Canada's power to influence the pace of development will not disappear.

Ironically, in Nova Scotia the issue of control has been raised by Petro-Canada itself. In the early 1980s, when Mobil Oil was the operator of both Hibernia *and* Scotia Shelf exploration, there was considerable concern (expressed by the federal minister and Petro-Canada) that Mobil was not moving fast enough on offshore Nova Scotia, having set its priority on getting oil developed off Newfoundland.

Petro-Canada seems caught in a cylinder where federal forces push it toward the national goal of self-sufficiency while, at the other end, provincial forces thrust against a perceived threat to their autonomy over constitutionally defined ownership and management rights. In British Columbia, Petro-Canada has been cast as the nefarious invader of provincial jurisdiction. Just prior to the coming into force of the *Canada Oil and Gas Act* in March 1982 (which removed Petro-Canada's preferential rights to lands not already under lease), the federal government issued Petro-Canada the mineral rights to 5.8 million acres off the coast of British Columbia. The whole exercise was academic in light of the decade-old moratorium on exploration; however, provincial officials objected to the authority apparently vested in Petro-Canada by the federal government, to control the timing and pace of development once the moratorium is lifted. Some solace was afforded by the majority decision of the Supreme Court of Canada on May 17, 1984, which vested ownership of the seabed in the Strait of Georgia in the province. The decision dismissed an appeal by the federal government from a constitutional reference by British Columbia to its Court of Appeal in which a majority concluded that the land and waters between Vancouver Island and the mainland at Confederation were within the province and so remain today.[21]

The market power of Petro-Canada has been a continuous thorn in the B.C. government's side. Petro-Canada produces about 30 percent of the oil and gas in British Columbia and owns 31.3 percent of Westcoast Transmission. The ownership of Westcoast came about through the 1978–79 acquisition of Pacific Petroleum. (As we will see, the control of Westcoast Transmission in the early 1970s by Pacific Petroleum, its U.S. parent and export customer, was a factor in the decision to create the British Columbia Petroleum Corporation.) Socred Transport Minister Jack Davis expressed the B.C. government's fears on control of production and transmission:

> I'm concerned about nationally publicly owned corporations if they become the sole instrument for development in the particular industry. . . . what's to say that Petro-Can won't be directed by a government in Ottawa to find more resources in a particular province and ship those resources, not for export and for sale at the world price but to other provinces — and notably the central provinces — at less than the world price?[22]

Premier Bennett voiced the opinion that "no government agency should control part of the economic instruments in another province," and

wondered if Petro-Canada's interest in Westcoast was part of a plan for a national agency to carry gas from the Yukon and Alberta, thus threatening B.C. revenues through non-utilization of B.C. "oil fields."[23]

As we shall see with Pacific Western Airlines, real power and perceived threats can combine to give one level of government the impression that the other level is malevolently intruding on its territory. The jurisdictional overlap and externalities of policy concerns can lead to a situation where governments may feel compelled to act to get around these constitutional barriers. In this section we examine several instances where the perception exists that provincial governments have been employing public ownership to violate the formal division of power.

La Caisse de dépôt et placement du Québec

> . . . the province building phenomenon indicates an awarness on the part of certain provincial governments that economic and industrial restructuring demands initiatives that are far more sophisticated and *dirigiste* than the fiscal and regulatory policies so common at the federal level.[24]

By the middle of 1982, a Quebec Crown corporation had emerged as the single largest shareholder in Canadian Pacific Ltd., Canada's biggest publicly traded company. Established in 1965 by the Lesage government, the Caisse de dépôt et placement du Québec manages more than $16 billion in funds controlled by the Quebec Pension Plan, the provincial auto insurance plan and the public service retirement plans. Thirty percent of these funds, or more than $5 billion, is available for equity investments in Canadian and foreign companies.[25] Up to 30 percent of any single corporation's equity may be purchased by the Caisse, a level of ownership which, if fully exercised, could lead to a position of effective control in many widely held corporations. By contrast, Alberta's Heritage Savings Trust Fund (AHSTF) has a five percent voting share ceiling.

Shortly after the Caisse raised its ownership in Canadian Pacific Ltd. to 9.9 percent of the voting shares, the federal government introduced Bill S-31 to limit provincial ownership to 10 percent of the voting shares in any transportation company operating across provincial or national boundaries.[26] The ownership limits were in addition to the controls available through the Canadian Transport Commission.

Bill S-31 in its original version died on the order paper. The same fate befell its amended successor early in 1984 when the sponsoring minister confirmed that the measure would not be reintroduced. It had become apparent that the Liberal federal government's support for S-31 could not withstand the strong combined opposition of Quebec, the other provinces and, perhaps most importantly, the private sector, which was demanding that federal corporate investment activities be similarly limited.[27]

However, the issue of public policy for federalism and economic power raised in the Caisse–Bill S-31 confrontation will not vanish. At most, a

truce has been declared while the principal players monitor each other's activities. For the moment, the Caisse has stopped buying into Canadian Pacific, and its attempts to be represented on CP's board have been rebuffed. If nothing else, the furor over S-31 has created a new status quo.

But the Caisse's stock portfolio moves toward the $6 billion mark and continues to rise as the funds available for investment grow. As part owner of over 300 companies, the Caisse represents the leading edge of direct equity involvement by a provincial government in nationally significant enterprises.

The Caisse and, to a lesser extent, the AHSTF,[28] confirm the high-stakes involvement of government as part owner of private sector companies. The Alberta fund is presently limited to a five percent ceiling in its holdings of any individual company's voting shares. However, Premier Lougheed announced on July 11, 1984, that his government intended to use the fund (as well as general revenue) to buy into major energy, transportation and cargo container ventures. More details on this interventionist shift are awaited, but present indications suggest that the Alberta government plans to be a more influential participant in several areas of business activity deemed to be of significance to that province's economic recovery.[29]

The emergence of the Caisse as the owner and manager of Canada's single largest stock portfolio did not become a matter of national interest until 1980. In part, this was due to management refusal to divulge the individual shareholdings of the Caisse.[30] The low profile resulted also from a fairly passive investment strategy that avoided visible confrontation with private economic interests in its pursuit of four primary goals: fiduciary protection of capital, diversity in investments, optimization of yield, and promotion of economic growth.

In 1979 the board of directors announced that "the Caisse henceforth must direct its resources increasingly toward Quebec's economic development," and promised the commitment of more funds to take equity positions in companies deemed to be important to the province's economic interests.[31]

As a result the Caisse has changed from a portfolio manager into a holding company in the past five years. Its equity investments include:[32]

- 9.9 percent of Canadian Pacific Ltd., representing over $260 million or 8 percent of its common stock portfolio;
- 7 percent of Aluminum Company of Canada Ltd. (Alcan);
- 30 percent (the maximum holding in a single company permitted by its legislation) in Provigo Inc., which gives the Caisse effective control thanks to a separate shareholder agreement with the Sobeys of Nova Scotia;
- 20 percent of Domtar Inc. of Montreal, which when linked to the 22 percent interest of another Quebec Crown corporation, Société général de financement (SGF), gives the Caisse direct control and commensurate representation on the board of directors;

- 30 percent of Brascade Resources, whose other owner, Brascan Ltd., effectively controls Noranda Inc., which in turn controls MacMillan Bloedel Limited, Canada Wire and Cable Limited, Brunswick Mining & Smelting Corporation Limited, and a number of other companies;
- 56 percent of Gaz Métropolitain, the natural gas supplier to greater Montreal; and
- possibly the biggest single holdings in Canada's seven largest banks and in Bell Canada.

On the non-equity side (70 percent of its managed funds), the Caisse is the principal purchaser of provincial bonds. In both its stock and fixed yield investments, the Caisse must be mindful of its fiduciary responsibilities in handling the funds of current and potential pensioners, claimants and retirees.

The decision in 1980 to lend to Quebec Hydro and the province of Quebec at less than market rates prompted concern about these fiduciary responsibilities, and this was exacerbated by the news that the Caisse had agreed to purchase a record amount of Quebec's debt load. These decisions focussed attention on the independence of the agency, whose directors are appointed by the cabinet.

Given the social and economic orientation underlying the Caisse's creation, it is clear that its independence is relative. The directors must fulfil their fiduciary responsibilities within the context of being sensitive to the interests of the government of the day. At no time is this potential for a conflict of interest more evident than when the Caisse's equity holdings are employed to exercise corporate control for reasons that appear to stretch the agency's original principal guidelines for investment. Examples might include:

- the move by the Caisse (together with SGF) to obtain effective control over Domtar after the company announced its intention to move its Sifto Salt headquarters to Toronto;
- the acquisition of a majority interest in Gaz Métropolitain following statements by the energy minister stressing the importance of having direct provincial control over natural gas distributors;
- allegations (disputed) that the Caisse, as a part owner of Canadian Admiral Corporation Ltd., had played a major role (in cooperation with another Quebec agency, the Société de développement industriel du Québec) in closing down an Ontario plant instead of the Quebec plant as recommended by management; and
- public musings by the Caisse's president that there ought to be some "clearing out" of CP's directors to prod the company into better performance.[33]

We have neither the time nor the resources to probe the complex relationship between particular investment decisions and fiduciary obligations,

and the dividing line between passive and active shareholders. Our concern here is to shed light on the implications for federalism arising from the decidedly targeted equity investments of the Caisse.

It was only a matter of time before the Caisse's direct involvement in the stock markets would bring it, and the Quebec government, into collision with a coalition of federal political concerns and established corporate interests. The chemistry came together with Canadian Pacific Ltd.; and Allan Tupper's analysis in August 1983[34] cogently and persuasively probed the intricacies (and forecast the immediate outcome) of the S-31 confrontation.

For our present purposes, this overview of the Caisse controversy illustrates several aspects of federalism that must be kept in mind in the current debate over economic development, public enterprise and the formal division of powers. The points may be summarized as follows.

1. Provincial savings pools, if organized and deployed as part of a government's economic strategy, constitute an important source of corporate influence whose exercise and application are not limited to provincial boundaries.
2. The active investment of even a portion of these funds in the voting shares of publicly traded companies represents a new development in the make-up of federalism and the allocation of economic power in Canada.
3. This shift flows from the "internalization" of provincial priorities and interests (to an undefined extent) in the direction of corporations whose ownership and ultimate control now originates in combined private and government investments.
4. Viewed in this light, government equity involvement in private sector companies poses significant challenges to our system of federalism because the contact points between the purchased companies and both levels of government are diverse and unresponsive to accepted divisions of constitutional responsibility. The demise of S-31 had very little to do with a legal dispute over the division of powers. In strict doctrinal terms, S-31 appeared to be a valid exercise of the federal authority over interprovincial transportation matters, in the vein of existing federal controls over provincial equity participation in the banking, airline and broadcasting sectors.
5. The Caisse represents the leading edge of provincial ownership of private sector companies. Recent announcements in Alberta forecast a more active employment of the Heritage Savings Trust Fund as a direct equity participant in major energy projects and transportation entities. Experience suggests that national regulatory responsibilities in transportation, for instance, may have little influence on important corporate decisions involving investment, employment, and purchasing. To this extent, the capacity for provincial influence, sometimes

direction, over significant market decisions must be more fully appreciated as a new element in federal-provincial relations and in the evolving nature of the economic union.

6. The full meaning of the advent of provincial holding companies in the market economy remains a matter of speculation. If public ownership is to remain as an important factor in the Canadian economy, then the Caisse study gives rise to the prospect that the extensive commingling of public and private ownerships in large corporations may create a supra-constitutional form of state capitalism.
7. The purposeful employment of the Caisse model in one or more other provinces would undoubtedly strain relations between the host governments and the private sector. The need for appropriate restraint and sensitivity by investor governments or, alternatively, comprehensive ownership limitations on both levels of government, will undoubtedly become necessary policy choices if present trends or proposed initiatives in Quebec and Alberta are realized.

Pacific Western Airlines

> In sectors of economic activity where the constitution allocates regulatory authority to the federal government, a provincial government is deprived of the ability to use direct regulation as a technique of intervention and may therefore choose public ownership as the only instrument available to it for participating in public decisions in such sectors.[35]

In July–August 1974, the Alberta government conceived and executed a surprise $37.6 million takeover of Pacific Western Airlines (PWA). Alberta did not seek the approbation of the federal regulator, the Canadian Transport Commission (CTC), as required by section 27 of the *National Transportation Act*.[36] The province successfully argued, in the court cases which followed, that the province was not a "person" within the meaning of section 27 and thus was exempt from CTC prior-approval requirements.

The conflict illuminates the complexity of the relationship between public corporations and the division of powers. Alberta saw a threat to provincial development strategy in the possible takeover of a key provincial industry and in a regulatory structure which was unable or unwilling to deal with regional concerns. A pre-emptive takeover would advance the provincial position and by-pass the existing division of powers. While the newly public PWA would still be subject to full CTC regulatory control, the very features of the regulatory regime which created the frustration, i.e., the inability of the CTC to deal with regional concerns over investment decisions and development plans, provided Alberta with a great deal of flexibility. The residual question of why the Lougheed government, through PWA, failed to take advantage of this flexibility and control will be examined later.

From a federal perspective, the PWA takeover was a threat to federal regulatory authority, and posed the danger of a fragmented air transport network if the Alberta model were copied (e.g., by Newfoundland taking over Eastern Provincial Airways).

The rationales and objectives of public corporations are complex and often confusing, particularly when governments buy them as going concerns. The purchase of PWA was complicated by the haste of the decision and the need for secrecy (to protect the integrity of the takeover bid and, not incidentally, to keep the federal government and its regulators in the dark until a fait accompli existed).

Tupper notes two themes in statements by Alberta politicians justifying the takeover: first, the legitimacy of using state power to defend provincial interests, and second, the role of transportation as an instrument of economic diversification.[37]

The Lougheed government perceived a threat to its nascent industrialization strategy in a stream of rumours and applications to the CTC for permission to bid to take over PWA. Transportation was seen as a key to the diversification of the Alberta economy in much the same way that the railways facilitated the development of the West and enhanced the industrial development of Central Canada. A new owner, like the leading candidate, White Pass and Yukon Railway, might have priorities for management and expansion which ignored or were contrary to Alberta's interests.[38]

The use of provincial power here must be seen in the context of the government's ideology and activities. John Richards and Larry Pratt, in their 1979 book, see state entrepreneurial activity in Alberta as a form of economic nationalism where a rising elite reacts to unequal distributions of national industry, wealth and power.[39] Alberta was attempting to consolidate and extend its control over resources, and to maximize rents as a step toward diversification. The government had already resorted to public enterprise through the creation of the Alberta Energy Company in September 1973, justifying that action in the name of the development of an indigenous petrochemical industry and the opportunity for Albertans to have equity participation in the industry.

However, there is no evidence that the Lougheed government has a predilection for public corporations. In fact, the PWA evidence suggests government purchase was a last resort. When Alberta heard of the White Pass plan in early June 1974, cabinet ministers attempted to interest Alberta business people in the airline. Only when these initiatives failed did the government become the buyer.

In March 1976, while the issue of the takeover and the necessity of regulatory approval was still before the courts, PWA announced its first politically contentious "management" decision — the plan to move the corporate head office of 40 executives to Calgary from Vancouver. The announcement quickly created a major interprovincial confrontation with

a number of different fronts (B.C. vs. Alberta; Alberta vs. Ottawa; Alberta government and appointed PWA board nominees vs. Don Watson, PWA president). British Columbia saw the move as the first evidence of its fears that B.C. development would be hampered by the airline's new policies as well as by the immediate loss of jobs to the province. The president of PWA saw the imposed move as the first step in the politicization of the airline.[40] After failing to convince the board to change its mind, Watson resigned. Criteria of economic efficiency in distributing jobs in line with revenue sources and growth prospects received short shrift.

The interprovincial dispute crystallized the federal view that provincial ownership posed a threat to the federal regulatory authority. They were afraid of proliferation and gradual balkanization, as provinces looked to their own interests at the expense of neighbouring regions. On August 5, 1976, the federal cabinet issued a restraining order amid broad hints that retroactive legislation was under consideration to invalidate the takeover, even if the Supreme Court decision was favourable.[41]

The February 21, 1977, decision was unanimous and strongly favourable to the Alberta position. Chief Justice Laskin downplayed any threat to federal powers and indicated that federal regulatory control over the airline was unimpaired, and that the federal government could change the legislation to close any regulatory gap. The decision led the federal government to withdraw its threat of retroactive legislation. However, in May 1977, the federal government quickly passed legislation to amend the *Aeronautics Act* and the *National Transportation Act* to ensure that any future attempts at provincial airline ownership would be subject to CTC and government approval.[42]

Tupper concludes that the underestimation of a number of environmental factors (regulatory process, relationship to private competitors, and the political culture in Alberta) severely constrained the utility of PWA as a policy instrument.[43] More important from our point of view is the question of whether an "invasion" of federal territory took place and, if so, what the consequences were for federalism and the economic union.

It seems clear that Alberta's intention, although vague and hurriedly conceived, was to affect the distribution of powers by using PWA as an instrument of development policy. Any ideas of PWA as part of a grand design to wrestle industry and political power from Central Canada founder on the rocks of political and corporate behaviour. In fact, it can be argued that the political controversy which the takeover generated caused the airline to be more cautious than it might otherwise have been.

Somewhat perversely, PWA became a very determined competitor for smaller carriers within Alberta while it maintained cross-subsidization (for users) outside the province.[44] Routes in the B.C. interior were reportedly losing $200,000 annually. However, any moves to eliminate them would have generated severe political conflict with British Columbia. (Only in

June 1984 has the re-privatized PWA applied to delete mandatory stops in the B.C. interior.)

Under public ownership PWA experienced steady growth and managed a profit every year despite the fact that it was operating in the areas hardest hit by the recession. In late 1982, the Alberta government formed a task force to explore the sale of the provincial interest in PWA. Its conditions were that there be wide distribution of shares and maintenance of control by Western Canadians. In November 1983, the sale took place, with the Alberta government retaining a 14.9 percent share.

After examining PWA's nine years under public ownership, one can only conclude that the impact of the relationship on federalism and the economic union has been negligible. The Alberta government's hasty intervention in defence of the perceived interests of the province was justified as a bold exercise in province building. In order to achieve its policy aim, the government needed to get around what was perceived to be a hostile regulatory environment. The corporate instrument provided a means to avoid the federal regulatory authority's involvement in the decision to purchase. What the province had not anticipated was the dynamism of the environment within which the corporate instrument was located. The highly visible legal and regulatory proceedings of the first three years, and the backlash from the province's one move into corporate policy making (i.e., the relocation decision) led the Alberta government to eschew the use of PWA for public policy goals, and eventually to begin the process of re-privatization, while maintaining enough control in a widely held share distribution to influence future events.

The issue of whether provincial control of interprovincial airlines threatens the formal division of powers remains unresolved. The case of PWA has not sufficiently tested the supposition. It is possible to construct a scenario whereby provinces could fragment transportation and discriminate against other provinces, but there are other methods to reach the same result without resort to public corporations. On the evidence, PWA as a public corporation did not threaten either the federal regulatory power or the economic union.

British Columbia Savings and Trust Corporation

The B.C. Savings case is a recent example of a long-standing reaction by provincial governments to federal control over Canada's banking system. One response is for the governments to go into the banking business themselves through the medium of a provincial savings office or similar vehicle. Such institutions preceded Confederation, and their successors survive today in Alberta and Ontario.

The B.C. attempt is chronicled here because the flourish and the promise of the initiative is recent, and is an instructive reminder of the

readiness of governments to choose state enterprise to carry provincial goals and priorities into the federal realm of chartered banking.

In June 1975, the B.C. legislative assembly authorized the establishment of a "near-bank," the British Columbia Savings and Trust Corporation ("B.C. Savings").[45] Premier Barrett promised that B.C. Savings would be a "social as well as an economic instrument which would offer to the people of B.C. an option other than the traditional banking system which is essentially eastern oriented."[46]

B.C. Savings was to be a provincial Crown corporation. The government proposed to keep a 90 percent interest and offer the remaining 10 percent to credit unions in the province. The bill went through the legislature in little more than a month and was supported by the official opposition (the Social Credit party) with the proviso that B.C. Savings was not to compete with the credit unions. The several Liberals then in the legislature expressed serious skepticism about the need for B.C. Savings (in light of the vigorous growth of credit unions as local financial institutions) and concern over the potential implications of government management and control. The issue of constitutionality was ignored in the debates.

B.C. Savings never came into existence. The legislation remains unproclaimed to this day and was not consolidated in the 1979 Revised Statutes of British Columbia. But it has not been legally extinguished, and could theoretically come into legal existence tomorrow if the Lieutenant Governor in Council (the cabinet) were to proclaim the act.[47]

Provincial savings banks have deep historical roots in Canada. The governments of Newfoundland and Nova Scotia established savings banks in the 1830s to provide "savings facilities at a time when private savings institutions were still underdeveloped."

Provincially perceived deficiencies in the private market for agricultural credit led to the establishment of provincial savings banks in Ontario and Manitoba in 1920, and in Alberta in 1938. The Ontario and Alberta near-banks remain in operation and the Alberta Treasury Branches (as they are called) compete directly with deposit-taking institutions in nearly two hundred Alberta communities.[48]

When he led off the debate on B.C. Savings in May 1975, the premier accused the federal banks of high interest rates, excessive profits and credit-granting practices that ignored the needs of women, small business and the native population. His accusations reflected the deep unease in Western Canada that the federal regulation of chartered banks had been insensitive or at least unsympathetic to Western economic interests.

These grievances coalesced in June 1973 in the joint submission of the four western provinces to the Western Economic Opportunities Conference held in Calgary. The premiers expressed their dissatisfactions and asked that the federal *Bank Act* be amended "to allow Provincial Governments to own and control existing banks, or to establish their own chartered banks."[49] Their call followed by nine years the initial efforts of the

W.A.C. Bennett government in British Columbia to establish the Bank of British Columbia in which the provincial government would hold a 20 percent interest.

The legislation for B.C. Savings provided for the issue of 20 million shares, and the Barrett government invited credit unions in the province to purchase two million of these shares. In the view of one commentator,[50] B.C. Savings had the potential to be a "super bank" with authority to provide a full range of financial services, including those normally offered by chartered banks, trust companies and mortgage lenders. The Crown corporation was also given the power to act as an agent for the province itself, or any other public bodies or persons, and to carry on the business of insurance in the areas of mortgage, guarantee and credit insurance. Deposits with B.C. Savings were to be guaranteed by the provincial government and, upon cabinet approval, the guarantee could be extended to other forms of borrowing, to the value of $100 million.

When one takes an overall view of the several attempts to establish provincial near-banks, two principal features emerge: first, the governments want to hold the controlling interest in the institution. This is the case regardless of political stripe — Alberta Progressive Conservatives, B.C. Socreds, or B.C. New Democrats; second, there is "the conviction that only a government-owned banking institution could rectify the hurts imposed on the provinces by the existing banking system."[51]

Both features figured prominently in the thinking behind the creation of B.C. Savings. There was no doubt that the corporation was a Crown agent.[52] The proposal to offer a 10 percent interest to the province's credit unions would not disturb the government's authority to run the affairs of B.C. Savings. Indeed, the bill was introduced without the premier's obtaining a firm commitment of participation from the credit union movement, whose leadership was wary of entanglement in a government-controlled savings bank.[53] In the next six months the government was unable to nail down their involvement, and, for all intents and purposes, the venture died with the defeat of the NDP government in December 1975.

The enabling bill sits, as it were, on the legislative shelf, a reminder of a frenetic initiative by a province to create a near-bank that was expected to provide local competition for the federally chartered banks. A bank in all but name, B.C. Savings never came into existence, and the case stands as one of the more curious endeavours in the annals of public enterprise in Canada. The constitutionality of its founding legislation was never openly debated and did not figure in its disappearance from the political agenda. The formal division of powers grants the federal Parliament the power both to incorporate banks and to regulate banking. However, the meaning of "banking" remains vague, and the provincial power to incorporate trust companies, credit unions and caisses populaires has never been seriously doubted. The issue to be resolved in each case — and the juris-

prudence is not particularly instructive — is to determine whether the particular provincial near-bank is carrying on "banking" activities restricted to federally chartered banks. Suffice it to say that neither the *Constitution Act, 1867*, nor the *Bank Act* has curtailed provincial initiatives in encouraging the local incorporation of provincial near-banks.

Recent proposals by the Government of Alberta for its Treasury Branches testify to the vagueness of constitutional powers over banking, and the distrust of the Toronto-based chartered banks by provincial governments in Western Canada. In its July 1984 white paper on provincial economic policy, the Lougheed government suggested an expanded role for the Treasury Branches in which they would broaden their deposit base, engage in merchant banking and export financing, and syndicate large loans with other institutions.

With assets of $3.4 billion, the Treasury Branches form the 19th largest financial institution in Canada and, as part of the Treasury Department, they are able to enjoy federal tax concessions and avoid deposit requirements, since the province is their guarantor. The instrumentality of the Treasury Branches figures prominently in the new initiatives and serves as a reminder of the elasticity of our federalism in practice.

British Columbia Petroleum Corporation

The creation of the British Columbia Petroleum Corporation (BCPC) was a policy response to a multitude of factors which achieved prominence in the early 1970s. The focus of our concern, and the immediate impetus for action in 1974, was provincial frustration at the failure of a federal regulatory body to act in defence of provincial interests.

Westcoast Transmission had a market position of monopoly and monopsony — it was the sole buyer of gas produced in British Columbia and the lone seller to El Paso Natural Gas, its U.S. customer. At the time, Pacific Petroleum had an interest in 50 percent of B.C. production and, with its American parent (Phillips Petroleum), owned 34 percent of Westcoast. Combined with El Paso's 19 percent share of Westcoast, this control of the monopoly wholesaler was not viewed as being healthy. More importantly, the province did not have the regulatory power to control this relationship. As a federally chartered company, Westcoast came under the jurisdiction of the National Energy Board (NEB). This situation caused some unease at the provincial level, but it took a chain of events in 1973 to precipitate change.

A new Energy Act transformed energy policy in British Columbia to an activist mode under the British Columbia Energy Commission, which recommended large natural gas price increases and the creation of a Crown agency to replace the royalty system.[54]

Policy was also responding to events arising out of existing contractual arrangements and physical production problems. B.C. production had

been cut by 20 percent as a northern field "flooded in." Meanwhile, Westcoast was in a bind. El Paso was pressuring Westcoast to buy gas (at a loss) from Alberta to meet its export contract volumes. On the supply side, B.C. producers had gone to arbitration and won price increases from Westcoast.

One solution was to increase export prices through the so-called "105 percent rule," which required export prices to be at least 5 percent greater than domestic wholesale gas prices. If B.C. Hydro could be convinced to increase the price it paid for wholesale gas, the increase could be legally passed on to El Paso, but B.C. Hydro refused to do this. Another possibility, suggested by the Social Credit opposition, was to make representations to the NEB.[55] The NDP government responded that the NEB had known about the problems with the El Paso contract and had failed to act under what was seen to be a clear regulatory mandate to impose a two-price system.[56] Under section 11A of the *National Energy Board Act*, Part VI Regulations, the NEB must report to cabinet if there is a "significant increase in prices for competing gas supplies or for alternative energy sources," and if cabinet can establish an export floor price.

Concurrent with the natural gas debate in British Columbia, the federal government had imposed an export tax of $0.40/barrel of crude oil from October 1, 1973. While the tax had a marginal impact in British Columbia, intergovernmental relations were soured by the perceived threat to provincial revenues and jurisdiction.

Within two months of the receipt of the BCEC report, the government secured the passage of Bill 70, the *Petroleum Corporation Act*, and the British Columbia Petroleum Corporation was born.[57] BCPC became the monopoly buyer of gas in the province, effectively turning Westcoast Transmission into a contract carrier operating on a cost-of-service basis. BCPC accomplished what Westcoast could not, the raising of all gas prices under existing export contracts.

The creation of a two-price system allowed the B.C. government to subsidize domestic wholesale gas prices with export earnings. In the first year of operations, provincial revenues from the corporation and natural gas royalties totalled almost $29 million, a 350 percent increase from the previous year's royalty figure. While the collection of rents was a key factor in the creation of BCPC, the choice of the corporate instrument was dictated by the regulatory regime and the contract problems rather than by any revenue imperative.

The corporate life of BCPC may be divided into three phases. The rationale for the first phase was frustration at the inaction of the federal regulatory body, and a desire to raise gas prices to commodity value. One might infer from the legislative mandate that the NDP government had some intention to expand the activities of BCPC into exploration and development.

The second phase, beginning in 1975 after the election of the Social Credit government, was a diminution of BCPC to the role of a "tax gathering device." The Socreds were not particularly enamoured of public ownership. But by this time the federal-provincial resources conflict had escalated and the B.C. government recognized the advantages of maintaining a corporate bastion against federal intrusions. Ownership of the resource gave the province a shield, under sections 109 and 125 of the *Constitution Act, 1982*, against federal attempts to tax the resource. This shield became particularly visible during the bitter 1980–81 period of energy price negotiations. In the budget and National Energy Program of October 28, 1980, the federal government introduced an excise tax on natural gas. Alberta companies were forced to pay the tax while the Alberta government mounted a court challenge to the legislation (Bill C-57). British Columbia's response was to direct its Crown corporations, BCPC and B.C. Hydro, to withhold the tax.[58]

By 1982, a combination of factors (recession, abundant competitive gas supply, high Canadian export prices, and B.C.'s position as the marginal seller vis-à-vis Alberta due to differing contract terms) had caused natural gas sales and revenues to plummet, providing the opportunity for a review of gas marketing and supply. Ironically, the provincial government on the one hand was begging concessional reductions in its take-or-pay obligations to Petro-Canada, the major gas producer, while on the other hand, vilifying the intrusive federal government and its corporate agent.

A review commissioned by the B.C. government recommended a change in the BCPC role from revenue collector to marketer; the adoption of a royalty system; and increases in retail prices to reflect full delivered cost (with subsidies in the form of explicit grants).[59] The third phase of "the life and times of BCPC" is now evolving, with the implementation of a royalty system in 1985. BCPC will continue to exist and shows some potential to expand;[60] however, in terms of federalism, the only remnant of interest to us (and perhaps one of the key reasons for keeping a corporate instrument at all) is the usefulness of BCPC as a defence against federal intrusion into provincial affairs. In the wake of the June 1982 Supreme Court decision, the B.C. government is likely to maintain the legal position of ownership by keeping BCPC as an instrument to "own" the resource early in the production cycle.

While the particular circumstances of the time created a measure of provincial frustration at the failure of the federal regulator to act in the perceived provincial interest, the continuing existence of BCPC has had less and less to do with any problems in the division of powers. The reversion to a royalty system in British Columbia is a basic indication that the corporate instrument has only a residual importance.

Newfoundland and Labrador Corporation (Nalco)

> Combined with the complicit backing of the provincial governments, the advantageous tax treatment available to some provincial Crown corporations could make them formidable competitors.[61]

The Newfoundland and Labrador Corporation (Nalco) is one of the clearest examples of a province's attempts to exploit to the maximum long-standing concessions made available under the *Income Tax Act* to provincial Crown corporations. The corporation was established by the Smallwood government in 1951 to attract private investors to the province. The hope was that the private shareholders would bring in development corporations to survey concession areas and, if indications were positive, proceed with development.

The corporate form appears to have been dictated entirely by Premier Smallwood's "discovery" that the federal government did not tax provincial Crown corporations.[62] The equity was divided to meet the *Income Tax Act* criterion[63] with the province providing 90 percent of the $1 million paid-up capital, and groups of Toronto and New York investors supplying the remaining $100,000. Nalco was ceded exploration and development rights to vast areas of Labrador and Newfoundland (including the water rights to the Hamilton River where the Churchill Falls hydro project was developed by Brinco in the late 1960s).

Unfortunately, the financial structure of Nalco helped to precipitate its failure as an instrument of development policy. By 1953 the initial capitalization was largely depleted and the government realized that the private sector was unlikely to invest in major developments for a mere 10 percent equity. Moreover, the Newfoundland government was not in a position to provide the millions of dollars required for the venture to proceed.

After unsuccessful overtures to Brinco, a minority interest was sold to John C. Doyle and Canadian Javelin Co., and the government continued to hold approximately 60 percent, until Wabash Mines took over as part of a royalty arrangement to develop an iron ore mine in Doyle's Labrador concession. The 60 percent interest came back to the Newfoundland government in 1963 at no cost under an "agreement" following heavy, but unsuccessful pressure by Smallwood to have Wabash build its iron ore pelletizing plant in Labrador rather than near Sept-Îles, Quebec.[64] The peripatetic interest was later sold to Canadian Javelin, and the wood supply area became the basis for Doyle's ill-conceived Stephenville pulp mill (which was in turn nationalized by the Moores government in 1972).

The attractions of the federal tax concession for provincial Crown corporations continued to appeal to the Smallwood government and in the late 1960s prompted the founding of a transitional or temporary government company. Under this tax shelter plan, the Government of Newfoundland would own at least 90 percent of the company's shares. A private

partner would manage the company for a fee and take an option to buy a controlling interest once the capital costs were retired. In the interim, the company would enjoy the tax holiday under section 149(1)(d) available to eligible provincial Crown corporations.

Apparently this tax avoidance scheme was applied successfully in the case of a fish plant and feed mill. The breaking point came with Newfoundland's decision to apply its interpretation of the concession in section 149 to John Shaheen's Come-by-Chance refinery. In this case, Shaheen agreed to buy the complex for $10 million and pay a five percent share of profits to the government in perpetuity after the capital costs had been retired.

The federal government, fearing the erosion of its tax base and prejudicial results for private sector taxpayers, moved to shut down the tax loophole. In 1969, section 149 of the *Income Tax Act* was amended to deny the tax exemption to any federal or provincial Crown corporations (or their wholly owned subsidiaries) in which outsiders held rights to acquire any shares or capital "either immediately or in the future . . . either absolutely or contingently . . ."[65]

The Come-by-Chance project was threatened, but the federal government eventually agreed to allow for a tax deferral in its case.

The Newfoundland experience illustrates, in both Nalco and Come-by-Chance, an overt readiness by a provincial government to take advantage of, and indeed to attempt to exploit fully, the tax concessions available under federal legislation since the inception of income tax in 1917. As noted, Nalco illustrates that preferential tax treatment may well be a formative influence in the creation of a provincially owned economic development company. However, the tax concession may only delay the demise of an otherwise unviable enterprise. The line between public ownership and private interests was broached in the Come-by-Chance refinery case. That experience confirmed the ultimate federal control over the scope and application of tax incentives for provincial Crown corporations.

The end result, in legislative terms, was to deny the tax exemption to "mixed" public enterprises, and to underline the federal government's determination to restrict the historic income tax concessions to public enterprises overwhelmingly owned by itself or provincial governments.

Provincial Hydro Authorities

> The decisions to nationalize the companies in British Columbia and Quebec resulted from a desire to avoid the taxes paid by private utilities to the federal government. Since a provincial Crown corporation is immune from federal income tax, the government in British Columbia and Quebec recognized that they would be able to reduce the cost of service to their provinces' consumers by eliminating the income tax as a cost of doing business. Thus the differential tax treatment of public and private firms created a significant direct incentive for public ownership as the regulatory instrument.[66]

In the history of provincial hydro authorities, it was the tax structure that provided a strong incentive for provincial governments to take over their power utilities. The natural monopoly which characterizes hydro operations provides a rationale for some form of regulation, and the inclination to choose ownership rather than other regulatory techniques is reinforced by the tax advantages endowed by public corporate status.

Although the tax exemption for provincial Crown corporations has been available since 1917, the potential scope of the favoured treatment did not surface publicly until nationalizations in 1962 created B.C. Hydro and Hydro Quebec.

When Quebec took over the private hydro utilities in 1962, the industry was paying approximately $15 million annually in federal corporate income taxes.[67] In British Columbia, Premier Bennett claimed that the residents were forced to pay higher electricity bills, some $1.35 million more in 1960, because of the taxes paid by B.C. Electric to the federal government. The premier made repeated submissions to the Diefenbaker government to abolish the tax, or rebate 100 percent of the revenue to the provinces. He forecast that, without a change in the federal attitude, the province "would have to take over the B.C. Electric Company in order to protect our consumers, and that the responsibility for such action would have to rest on the Federal government."[68]

It would be misleading, however, to conclude that preferential federal tax treatment was the major motivating factor behind the creation of Hydro Quebec or B.C. Hydro. This becomes clear when it is recalled that the tax concession had been available for the previous 44 years. In the B.C. case, the takeover of B.C. Electric was much more influenced by the premier's commitment to government-directed power projects on the Peace and Columbia rivers. Neither B.C. Electric nor the federal government would foil those megaprojects.

The mix of factors which led to the provincial takeovers of private hydro utilities makes any ranking of the factors highly problematic and suspect. However, it is fair to conclude that the differential tax impact between public and private companies has been an influential element in the expropriation decisions. Until the recent focus on the creation, or expropriation, of resource revenue collectors (e.g., Potash Corporation of Saskatchewan, BCPC, Asbestos Corporation), few other sectors where provincial ownership could be justified politically offered profits large enough to realize significant tax savings.

In recent years, rising debt loads and significant drops in forecast demand have cut sharply into the profit pictures of the utilities, and it might be questioned whether the tax factor would figure in any present-day provincial takeover decisions.

More significant, however, has been the effect of the *Public Utilities Income Tax Transfer Act*, passed by Parliament in 1966. This legislation authorizes payments to the provinces equal to 95 percent of the tax col-

lected from private electric and gas utility companies, and then exempts from income tax those amounts transferred by the provinces to the companies.

The creation of a neutral tax system between private and public utilities responded to provincial representations and proved feasible for a single-industry situation. The net result has been the removal of tax advantages as a factor in future provincial utility takeovers.

In addition, the symbolic importance of an existing model (e.g., Ontario Hydro)[69] may reduce the political costs of nationalization to the point where the policy has much broader applicability than it might have in another sector. The case of PWA is instructive in this respect. It is possible that the existence of a large Crown airline in another province might have diminished criticism over the statist role of the province and encouraged the Alberta government to go beyond its defensive investment to use PWA as an active instrument of public policy.[70]

Conclusion

In this section, we have considered six examples of provincial ownership to gauge the relationship between public enterprise and the formal division of powers. The case studies raise the core issue of whether the arrangement of constitutional powers ought to be more explicit about a government's "power to own" in light of the readiness of both levels of government to exploit the corporate instrument to skirt the established channels of federalism.

Upon closer examination, the "power to own" constitutes an extension of the unclearly delineated "power to spend." Equity investments, credit supports and debt guarantees are the various forms of expenditure used by governments to establish and support their corporate offspring. Our studies confirm that provincial governments are prepared to set up their own companies to push for local development, and that the provinces are aware of the federal tax concessions toward provincial Crown corporations when they choose the corporate form to pursue provincial development priorities.

For several reasons, however, this picture of the provincial swashbuckler ought to be kept in perspective. The recorded experiences are of only modest significance when compared with the range and frequency of the other instruments of jurisdictional outreach. The individual provincial governments regularly affect interests, policies and "rights" in other parts of Canada through their separate regulatory and spending actions. These may take the form of marketing boards, public sector purchasing policies, employment preference programs or investor assistance schemes. On a more general plane, the provincial initiatives in "extraterritorial" Crown corporations must be viewed in the context of a larger phenomenon — the persistent growth of all government activities.

The case studies lend some weight to the view that the tendency of provincial governments to create corporate entities to surmount constitutional difficulties may be on the wane. For the moment the Caisse stands alone as a provincial holding company in interprovincial concerns, and confirmation of its active style awaits the aftermath of the federal and provincial elections. The B.C. Savings and Trust Corporation remains an asterisk in the experiments of provincial near-banks. Pacific Western, for its part, wends its way back into private-sector hands. The continued survival of the B.C. Petroleum Corporation rests on the legal primacy of resource ownership rights.

The Nalco and Come-by-Chance cases proved to be sunset enterprises devised to take advantage of federal tax concessions for provincially owned corporations. Their stories show that tax holidays only delay the demise of unviable ventures, and it is because of these cases that mixed corporate ventures will no longer qualify for the federal tax exemption. To the extent that the federal tax exemption in section 149 influences the creation of provincial Crown corporations, the result has been to strengthen the channelling force of the formal division of powers. The federal capacity to restrict or even eliminate the provincial claim to a tax exemption, borne out in the 1969 amendments, serves as a warning that the federal authorities will likely cut off the preferential treatment should their tax base be materially threatened by a significant increase in eligible provincial Crown corporations, particularly if those Crown corporations are engaged in commercial activities in competition with their private sector counterparts.

While the creation of the provincial hydro corporations testifies in part to the incentives provided by the federal tax laws, the documented influence of the tax concession is elusive and, in any event, has been effectively removed since 1966 by the granting of similar benefits to private utilities.

Nevertheless, the potential for aggressive use of provincial Crown corporations remains. The pressure for interventionist policies by all governments may mount as economic recession and high unemployment continue to plague Canada. Alberta's announcement in July 1984 regarding the equity position of the AHSTF suggests that the powers to spend and own may well take on renewed significance. In other words, the present anti-state bias in Canadian politics could well be replaced by a burst of intervention. Public corporations, wholly or partly owned by provincial governments, undoubtedly would figure in this expansion.

The cases surveyed suggest a readiness by both levels of government, particularly in the past twenty years, to use the corporate form to test the limits of federalism. This experience is part and parcel of the growth of state-related activities in that period. More fundamentally, however, the extension of public enterprise has provided additional proof that the formal division of powers means less and less in the dynamics of modern federalism. Public ownership by one level of government in sectors regulated by the other level has confirmed that the practical essence of

federalism is the sharing, not the splitting, of powers by its member governments.

Joint Ventures and the Machinery of Federal-Provincial Relations

> The joint venture is the most flexible instrument for making fits out of misfits. It will become increasingly important. It is at the same time the most demanding and difficult of all tools of diversification and development — and the least understood.[71]

Introduction

In the following three case studies we illustrate some of the virtues and limitations of the joint corporation enterprise model as a mechanism of interaction between the federal and provincial governments. The need to develop mechanisms which would encourage cooperation and collaboration between the two levels of government was a major theme during the Commission's hearings and was reflected in its interim report.[72] The academic literature and the comments of practitioners suggest that the existing machinery and processes can be ineffective or even conflict creating.[73]

The joint venture, a concept borrowed from the lexicon of international business, has become an important — even glamorous — instrument of governance in the last 15 years. For the purposes of this paper, a joint venture is defined as the shareholding or membership[74] involvement for a substantial period of time of two or more governments (or their agents) in a corporate enterprise to deal with a shared concern.[75] We should point out, however, that the joint venture is rarely construed in such a narrow sense in Canada. While there are a small number of joint enterprises in this country which involve only governments or their agents (i.e., public corporations of the parent government) as owners or members,[76] the joint enterprise model has been used far more frequently in Canada to allow for the participation of private sector investors — both corporate and individual — in a "mixed" venture with one or more governments.[77]

This mixed public and private quality of joint ventures is so pervasive that all three of the joint enterprises which we examine have (or would have) private sector owners or members. In all three cases, the governments were directly involved at the point of creation or purchase. Such corporations are likely to be more accurate reflections of the purposes of their parent governments than joint ventures where the ownership or membership interest is held by public corporations removed from the governments in question.[78] These examples should therefore be more illustrative of the potential and the problems of the joint venture model with respect to federalism.

Joint ventures appear to be employed most frequently by Canadian governments in the following general areas:

- bailout of failing firms;
- support for research and development;
- stimulation of high technology industries; and
- large capital projects.

The first of our case studies, Fishery Products International Ltd., focusses on a rescue operation; the second, Forintek Canada Corporation, concentrates on the support of research and development. The third case study goes beyond the areas of activity in which joint ventures are presently found to speculate on the viability of a joint venture model in the area of export development. A more extensive examination of the joint enterprise phenomenon could include the Massey-Ferguson bailout by the federal and Ontario governments,[79] the sordid story of the propping-up of Consolidated Computer Inc. involving the same two governments,[80] and an account of the development of Syncrude Ltd. featuring (at the outset) the Alberta, Ontario and federal governments, Esso Resources, Gulf Canada Resources, Canada Cities Service, and a number of minority interest private sector participants.[81]

What is the attraction of the joint venture model as a vehicle for federal-provincial interaction? It is not a mechanism adaptable to the day-to-day "firefighting" which characterizes much intergovernmental interaction, since it implies a long-term relationship. Even more than its "straight" cousin, the wholly owned Crown corporation, the joint venture offers the government participants excellent opportunities to distance themselves from the activities of the corporate enterprise in question. Responsibility for results is diffused among the various players and, because private sector involvement is so common, the rules of the game are more often those of the marketplace than those of bureaucrats or politicians.

The most significant virtue of joint ventures is that they are not, like so many aspects of federal-provincial relationships, characterized by the notion of a zero-sum game. Because joint ventures are generally used in the areas of bailout, research and development, etc., they tend to be associated with the leading edge of government's active role in the economy. In other words, they are vehicles through which governments expand their joint jurisdiction by further diminishing the scope of the private sector. Therefore, on the government side there are no "losers"; everybody gains more territory over which to exercise control or, at least, influence. The positive-sum potential of the joint venture involving private sector participation was accented in stark terms recently by the substantial capital gain made by the U.S. government through the equity it held as part of the Chrysler bailout.

Another positive factor is that joint ventures tend to reduce rather than exacerbate "turf" disputes between levels of government. A joint ven-

ture makes it clear that the problem is being dealt with in a cooperative way, because all the parties share a common interest or concern. Furthermore, the degree of each party's interest is usually made precise through the division of the equity and the establishment of the board of directors. Therefore, the involvement of a provincial or a federal government makes it unlikely that the joint venture will be subject to harassment from either government regarding purported violations of the formal division of powers.

The joint venture, as business analyst Peter Drucker notes, also allows for the knitting together of "misfits." It is a good vehicle for bringing together participants who have useful things to offer to a common purpose but who, without the bond of participation in an identifiable and discrete joint venture, would be unable to suspend their conflicting loyalties to province or nation. Thus, joint ventures could reproduce in a corporate, "economic development" setting, the kind of "trust networks" among program professionals identified by Dupré as a central component of "cooperative federalism."[82] Symbolically, the joint venture makes it clear that all parties are "onside." This may be extremely important when private capital is involved (at least when it is involved voluntarily).

One of the essential features of a joint venture is its capacity to diffuse risk. The joint enterprise model is used in bailouts and large capital projects because it allows the participants to avoid overexposure and to spread tax revenues over a wider spectrum of opportunities. Finally, as we have noted, a most significant quality of the joint enterprise model is its capacity to absorb private sector participation.

Fishery Products International Ltd.

> . . . the degree of mistrust, indeed animosity, that exists among the participants in this industry — fishermen, processors, provincial governments and the federal government alike — is such that it is almost impossible to persuade participants that *any* government decision is fair.[83]

In September 1983, the federal government and the government of Newfoundland and Labrador signed an agreement to restructure the Newfoundland fishery. A new company, Fishery Products International Ltd., was created with ownership divided between the federal government (60 percent), the Newfoundland government (25 percent), the Bank of Nova Scotia (12 percent) and prospective equity participation by employees (3 percent). The restructuring came about as a result of negotiations among governments and creditors of four failing (and failed) Newfoundland companies: Fishery Products Ltd., John Penny and Sons Ltd., Lake Group Ltd. and North Atlantic Fisheries Ltd. The goals and terms of the restructuring are strongly influenced by the recommendations of the Task Force on Atlantic Fisheries (known as the Kirby Task Force after its chairman, Michael Kirby) which reported in December 1982.

The use of the joint venture instrument must be seen in the context of the "jurisdictional sandwich" of fisheries, and the economic importance and circumstances of the industry. The division of jurisdiction is at the core of the necessity for cooperative approaches and coordinative mechanisms. Resource management and harvesting, as well as international and interprovincial trade in fish products, come under federal jurisdiction, while the provinces exercise control from the time fish are landed until they are sold across a provincial boundary.

The significance of the fishery to Newfoundland goes beyond economic impacts to encompass wider issues of social organization. The fishery in Newfoundland employs 20,000 to 30,000 people (out of a labour force of 200,000), and processing plants are the leading manufacturing industry.[84] The four major companies (Fishery Products Ltd., Lake, Nickerson and National Sea Products) involved in the Newfoundland and Nova Scotia rescue operations account for 40,000 jobs and 35 to 40 percent of the value of Atlantic coast fish production.[85]

Three circumstances which precipitated the 1982 crisis are identified by the task force: overextension and overcapitalization, aided and abetted by governments at both levels; resistance to change and adjustment; and the current politics of the fishery which inhibit change, shelter inefficiency and lead participants to battle for turf.[86] Kirby found that the largest companies were in the worst financial shape, with a "grossly inadequate" equity base. Without refinancing, some potentially viable firms would not survive to benefit from the structural changes proposed.

The need for joint federal-provincial cooperation was almost predetermined by the shared jurisdiction, the strategic importance of the industry, the existing debt held by the Newfoundland government, and the magnitude of the equity requirements. Equity involvement seemed a logical choice given the urgent requirements and the need to avoid bailing out existing shareholders, which precluded any sort of grant program. Loan guarantees were also considered and rejected because the need was for equity; the companies were unable to meet interest payments (of $1 million per week) on their existing loans.[87]

The advantages of joint action in the avoidance of competitive policies are obvious. Kirby attributes much of the climate of blaming the problems of industry on others to an absence of policy coordination. For example, the federal government blames the provinces for licensing too many fish plants and providing cheap loans which encourage the misallocation of funds. The provinces blame the federal government for the excess processing capacity, saying that the total allowable catch is not being properly allocated.[88] Governments working together, particularly when they share a financial stake, are less likely to implement policies which threaten their own best interests.

Given the necessity for coordinated action, and adding the debt involvement of the Bank of Nova Scotia, the joint venture corporate form was

an attractive possibility for the restructuring of the fisheries. Less expansively, one might argue that the three parties became buyers of last resort, since no other investors were prepared to come forward, and all the participants had more to lose in a bankruptcy, politically and financially, than they did by joining cooperatively. In line with the Kirby recommendations to avoid ongoing financial assistance programs and to make the restructuring assistance a "one-time effort only," and keeping in mind the primary objective of economic viability, the corporate structure, with its focus on the bottom line, was considered advantageous. Similarly, representation on the board of directors could be designed to reflect the relevant risk exposure of the various participants.

The joint venture, by providing a vehicle at arm's length from government, *may* be able to operate by the rules of the marketplace and avoid politicization of the organization. There is symbolic value in this separation and in stipulations that no federal politician or civil servant may sit on the board. The latter condition was an attempt to deal with potential conflicts of interest and charges of favouritism arising from fish stock allocations by the Department of Fisheries and Oceans. The joint venture, at one remove from a Crown corporation, eases fears in some quarters that government is nationalizing the industry; however, with 85 percent of the common shares and nine of eleven board appointments under the control of the two governments, the assertion by the Department of Fisheries and Oceans that there is no nationalization because there is no creation of a Crown corporation or "state enterprise" is disingenuous.[89] The provision in the legislation (section 4(2)), and in the agreement, for divestiture of shares and assets to the private sector after the enterprise becomes "economically viable on a continuing basis" is an additional "pacifier" for those who fear *dirigisme*.[90]

Drucker's description at the beginning of this section (note 71) of making fits out of misfits is a wonderfully apt portrayal of one of the benefits of this joint venture. Mutual distrust is often based on misperceptions of motives or intent, but through operational contact the various participants may begin to appreciate the actions of others. The mutual distrust and acrimony on the fishery issue was certainly consistent with the relations between the two governments during the negotiation period — particularly over resources (e.g., offshore jurisdiction, and the pricing of Churchill Falls hydro sales to Quebec).

As the negotiations on restructuring progressed, it was clear that Ottawa and St. John's were headed for fundamental disagreement on the issue of the "social fishery." Newfoundland, not without some federal cabinet members' support, rejected the Kirby primary objective of making economic viability the operating principle of the industry and insisted on an "all-plants-open" policy. The task force suggested that some plants would have to close in order to deal with overcapacity and it was essential for the new company to have the right to close unprofitable plants.

In May 1983, a memorandum of understanding was signed by the federal and Newfoundland fisheries ministers which left the question of the closure of the unprofitable Burin and Grand Bank plants up to the management of the new company. This proposal failed to get through the provincial cabinet, and an August pact failed at the federal cabinet. In between these events, the federal government announced a unilateral restructuring involving a federal equity infusion, a Bank of Nova Scotia debt conversion and a deferral to management on closures.

Newfoundland and the fishermen's union in Newfoundland let it be known that they would do anything to see the deal fail. In addition, there was the looming presence of the Canada Development Corporation (CDC) which appeared to be engaging in a form of internecine warfare with the federal government. The CDC held control of Fishery Products Ltd. and was bargaining very hard with the government on takeover terms. Matters escalated through name-calling, the transfer of assets offshore through numbered companies, and lawsuits and countersuits over the course of the summer. After the federal government had acquired the other major companies, there was little to be gained by the stand-off. The Newfoundland agreement was signed in September, and in late October the CDC gave up its Fishery Products shares and all legal actions were dropped.

The use of the joint venture seemed very attractive and was probably the only way to get feuding parties together. However, two unresolved questions remained: first, whether the new company could focus on its economic mandate and leave the decisions on a "social fishery" to governments and politicians, or whether it would become just another form of subsidization; and second, whether the joint structure makes accountability and locational decision issues even more intractable than under a sole public owner. On accountability, the recent transfer of federal holdings to Canada Development Investment Corporation is probably a cause for concern, given the CDIC record on other holdings.

Forintek Canada Corporation

> It is very important to keep the forest products industry of B.C. competitive. This is why we are here. We can provide the technical input to keep that competitive edge, to increase that productivity. Let's face it, the edge that you find in the business place is not one of magnitude; it's a very thin edge. We can help sharpen that in some slight way.[91]

Forintek Canada Corporation was incorporated under Part II of the *Canada Corporations Act*[92] in February 1979 following a decision by the federal Department of the Environment to "privatize" the wood products research laboratories of the Canadian Forestry Service (CFS). At the government level the common denominator is some sharing of jurisdictional turf. While the constitutional jurisdiction for forests rests with the provinces, the federal government has become involved over time in a number of forestry-related activities, such as renewal, environmental

impacts, and research and development. The initial focus on forest research to serve national goals was never seriously challenged and, even during the more fractious federal-provincial conflicts over resources, the jurisdictional issue did not surface.

In a classic economic example of the problems of public goods and free riders, research and development efforts generally have fallen to the federal government as the supplier of last resort.[93] Where the beneficiaries of an action are not readily clear, it is difficult to allocate benefits — and thus costs. Similarly, if the federal government was willing to do the research work, the provinces seemed satisfied to free ride on the benefits of that research and allocate their resources to other areas.

In the forestry area at the federal level, confusion reigned, since eight different departments were involved in forest activities. Only three provinces had forest research programs in 1979 (British Columbia, Ontario and Quebec), with an aggregate expenditure of just $10 million.[94] In the private sector only Domtar and MacMillan Bloedel were said to have "significant" forest product research establishments.[95]

In addition to the research imperative of more funding, the federal government had concerns which eventually pushed it toward a joint venture. The first consideration, to address the free-rider problem, was a broad policy view that those who received direct benefits of research in the form of increased profits or proprietary rents (fees, permits, taxes) should be funding at least some of that research.

A predisposition toward privatization (although not necessarily joint ventures) was evident in the budgetary and operating methods of Environment Canada, where most of the activity related to forest research resided under the Canadian Forestry Service. In the late 1970s the implementation of surveillance/monitoring in the new 320-kilometre coastal economic zone placed great demands on Environment Canada's funds. After a request for additional funds was refused by Treasury Board, an internal search focussed on the Environment Services Programs (since internal resources were being marshalled toward the expanded Fisheries and Marine Services Program) and the research labs were an obvious choice.

Coordination of research offered the possibility of greater efficiency, since the smaller research efforts of the companies and provinces were combined with the larger Environment Canada effort. A more cohesive package would avoid duplication and would broaden participation in setting research agendas. Other instruments, such as a discriminatory tax levied on the forest industry, would have left the provinces uninvolved, and indeed could have created constitutional conflicts, while a federal-provincial shared-cost program would have omitted the participation of the private sector.

In addition, the federal government already had successful models of corporate funding in the other key forestry research organizations in Canada — the Pulp and Paper Research Institute of Canada (PAPRICAN),

and the Forest Engineering Research Institute of Canada (FERIC).

The choice of the joint venture type of corporate vehicle was largely determined by the necessity to involve all three interested groups in research funding and decision making. In turning what had been a "research" focus to a practical emphasis on "development," the corporate vehicle offered the ability to respond flexibly and demonstrate sensitivity to research needs.

Once the federal government decided to privatize, the provinces were left in a position whereby failure to contribute would have been politically contentious in view of ongoing conflicts over other resource revenue and jurisdictional matters. British Columbia was in a particularly uncomfortable position as the only province with direct forestry revenues exceeding expenditures.

The question of the participation of the forest product companies is at the heart of the choice of the joint venture model. If the goal had simply been to bring the provinces in on funding universally beneficial forest research, a shared-cost program would have sufficed. The original goal not only included private sector participation by major forest product companies but also included assisting smaller companies which would not have the resources to carry out their own research. The corporate interest in development-oriented research provided a further incentive to establish an administrative form separate from government departments.

The free-rider problem was among the observed barriers to a rapid, positive response to private sector membership. The companies lacked the political imperative of the provinces, and a cautious approach was predictable given the status of Forintek as an unknown entity without a track record in the area of applied research. Companies did not know what they could expect in the way of identifiable benefits, or even whether the research output would be transferable to their operations.

The new emphasis on contract research after privatization provided a useful means of attracting private sector interest and enhancing credibility. While this was probably a necessary requirement at the time, to attract private sector participation, an inherent contradiction developed between the goals of disseminating research knowledge, and the proprietary interests of the private contractors. Now that the corporation is established, the contradiction is being handled by reducing the importance of contract research with proprietary concerns, although contract research continues to provide about 50 percent of operating revenues.

Just as the problems of the transformation from a government to a corporate organization (e.g., design and implementation of a fair assessment system) have been resolved, the funding distribution goal of 50:25:25 (federal:provincial:private) has been achieved. The forest industry share of funding has doubled since 1980–81, reflecting the growing credibility of the organization, and the increased competitiveness of the export markets for Canadian forest products, which makes the research contributions to productivity crucial.

One of the key coordinating mechanisms introduced in 1980 was the formation of two 17-member research program committees (RPCs) — one each for east and west. The RPCs provide advice and guidance to the board and to the management of Forintek on the medium- and long-term goals of the corporation, and ensure that research is "relevant to the needs of industry and government." Coordination of the RPCs is achieved through the 22-member board of directors and Forintek officers who serve on *both* RPCs. (At least three members of each RPC, including the chairman, must come from the board of directors.) In the formative stages of the corporation, the RPC membership was a cross-section of what Forintek would like its membership list to resemble, particularly in the area of provincial input. Initially, provincial commitments were lukewarm, with only some making voluntary contributions, but now five provinces are active participants (British Columbia, Alberta, Ontario, Quebec and New Brunswick).

Forintek's large board of directors meets three or four times each year and serves as a forum for forestry interests. Participation on the board is at a very high management level: assistant deputy to deputy minister (government) and vice-president up to chairman (private sector).

The future of Forintek as a joint venture seems relatively secure. The process of private sector and provincial involvement has evolved to the point where a productive, cohesive relationship exists. Even in what are extraordinarily hard times for the industry, only a few of the most financially strapped firms are not members. The question of whether the joint venture form can be extended to other research or public goods areas requires further study. There may be some possibilities for expansion in areas of common property resources, such as fisheries research, where resource endowments have an uneven regional distribution, although the current financial position of the saltwater industry on both coasts and the absence of provincial property rights and direct resource revenues lead one to believe that the possibilities here are limited for the present. One could also examine the possibilities for sharing research costs in areas such as nuclear technology, where the benefits of large federal appropriations currently flow to a few provinces only (primarily Ontario and New Brunswick) and to export markets. In this instance, private sector participation would be aimed at firms which might benefit from transfers of technology and from sharing in new research applications of nuclear technology.

A Joint Federal-Provincial Trading Corporation

In the enthusiasm to apply the lessons of the Japanese economic miracle to Canada, much significance has been attached to one institution, the "sogoshosha" or state trading corporation.[96] Proposals have been made at the federal level for the creation of a national trading corporation which would take the form of a shared or joint enterprise "up to 50% owned

by the federal government, with the other half of the equity held by perhaps 10 private sector investors."[97] Parallel proposals for provincial trading corporations have been entertained within at least two provincial governments (Alberta and British Columbia).[98] While there is no single agreed-on model,[99] the most commonly discussed proposals envision that a trading corporation in the Canadian context would probably be constituted as the central focus for exporting, importing and third-party trade between foreign countries in the industrial and service sectors. It could provide general trade services (including market intelligence, marketing and sales, procurement, transportation, financial support and the capacity to deal with state-to-state trading) and a range of services associated with the selling, packaging and management of large "turn-key" capital projects.[100]

It is sometimes overlooked that Canada has a significant tradition of state trading corporations. Both levels of government have experience with corporate state trading organizations devoted to international marketing of natural resource products. At the federal level, the Canadian Wheat Board has been a part of the machinery of government since 1935. The Canadian Commercial Corporation has, since 1946, played a limited role as a contracting and procurement agency for Canadian exports of goods and services. More recent additions to the federal inventory include the Canadian Saltfish Corporation and Canagrex. The latter was to become involved in the international marketing of agricultural products, but announcements by the new federal government have placed its future in doubt.[101] At the provincial level, probably the most prominent example of a marketing corporation is Canpotex, a joint venture involving the state-owned Potash Corporation of Saskatchewan and the private potash producers in Saskatchewan.[102] In addition to these marketing instruments, both federal and provincial governments have energetically entered the field of trade development with a wide variety of tax incentive, subsidy, information, financing, insurance and adjustment assistance programs.[103]

The degree of "fit" between the Japanese-inspired trading corporation model with substantial state involvement and the actual needs of Canadian exporters is a matter beyond the scope of this case study. Suffice it to say that a wide spectrum of informed opinion insists that many of the tasks which a state trading corporation could do are not presently being done for the manufacturing and service sectors in Canada.[104]

The next question drags this policy issue into the arena of federalism. If the functions performed by a state trading corporation are necessary, would they be best performed *jointly* by the federal government and at least some provincial governments? Or should the federal government and the interested provincial governments proceed on their own? To carry the discussion forward, we will consider two related propositions: first, that a reasonably strong case can be made for joint action, and second, that the most appropriate vehicle of coordinated action between the two levels of government is a joint corporate enterprise.

A number of considerations militate in favour of the joint approach. The most prominent and obvious factor is that joint action would avert the possibility of duplication of effort by the federal and provincial governments in a policy area where both levels of government are active. It is hard to imagine the circumstances in which parallel federal and provincial trading agencies could achieve the desired objectives for the respective governments as efficiently as one agency. A joint operation might also be the key to the viability of the agency — a more basic concern even than its efficiency. A worldwide network of specially trained personnel, for instance, is a key component of the survival and success of a trading agency. It is unlikely that a provincial trading body could achieve the "critical mass" required to allow it to recruit the numbers and breadth of talent necessary to buy and sell effectively in a variety of international markets. Similarly, a trading agency drawing on several treasuries is more likely to be able to establish a capital base adequate to back up substantial transactions of large "turn-key" projects. The House of Commons Special Committee on a National Trading Corporation estimated that a trading corporation involvement in five capital projects and $1 billion worth of general trade within five years of inception would require a $300 million equity base.[105] Joint action would appear to be an excellent vehicle of interaction between federal and provincial governments in a situation where continued financing is a substantial issue and risk is high. Finally, a joint operation with the involvement of several provinces would strengthen the capacity of the trading agency to seek out and engage the most appropriate private sector firms for the various project consortia.

On the debit side of the sheet, a joint trading operation does raise a number of concerns. First, the diffusion of responsibility across several governments can create problems of direction and accountability. Second, as with all such activities, it is hard to balance investment and return. At a political level, it is easy for one government or another to be labelled a "free rider." Finally, a point which Allan Tupper made about federal government initiatives with respect to industrial strategy is equally applicable to the process of joint trade development: ". . . efforts to enhance Canada's share of jobs and industry in a global context cannot be divorced from debates about the location of industry within Canada."[106] Joint action will do little to cure complaints about Central Canada's propensity to gain the most from the fostering of industrial and service sector exports. But representation of all provinces on the board would provide an important antidote to these fears.

Assuming that a case can be made for joint federal-provincial action on a state trading agency, then a jointly held corporation becomes the obvious instrument choice. Most of the advantages which flow from joint action, in fact, are probably dependent on the use of the joint corporate form. No substitute instrument (e.g., a shared-cost program) would provide the legal convenience, the sense of equity of partnership, the flexi-

bility in terms of personnel recruitment and management, and the symbolic value in the international environment that would flow from the joint corporate model.

In fact, most other instrumental options for trade stimulation have been tried. As Tupper and Doern point out, it is traditional in Canada "that public ownership is more frequently added to an array of existing instruments that have been tried and found wanting, or at least are believed to be found wanting."[107] In the end, it could be argued that the wider circumstances virtually preclude the use of any other organizational form than a joint corporate venture. Private sector participation is considered by all commentators to be de rigueur, and the corporate form offers the only viable means of allowing for outside ownership or membership.

The potential usefulness of the joint corporate enterprise model does not preclude problems in its establishment and operation. Not all provinces would want to participate in a trading corporation that focussed on manufacturing and service sector products. Some would be interested only if primary products were added to the mix. Some provinces might prefer the notion of regional trading corporations (e.g., Maritime or Western province groupings focussing on relevant mixes of primary, manufacturing and service products). Others might agree to minor levels of capital participation in a national corporation, but would expect an equal voice on the board of directors with those provinces that are heavily involved.

Obviously, the success of a joint venture (in this case in the area of trade development) is not measured solely in terms of its capacity to coordinate the often mutually incompatible and even competitive actions of the federal and provincial governments. A joint venture trading corporation must, in the first instance, improve Canada's trading position. The fact that this eventual measure of performance confronts the various government participants may itself be a catalyst to the success of the joint venture as a mechanism of federal-provincial interaction. The joint ownership mechanism puts all of the participants in the same lifeboat, confronts them with a common data base with respect to the prospects and problems of trade development in specific sectors, and makes success contingent on a significant degree of cooperation and compromise. It reduces the likelihood that individual governments will lay the blame for setbacks on other governments. In short, in a policy area such as international trade where a commercial orientation is required, where the risk is high and private sector participation is essential, the joint corporate venture might well prove a useful addition to the available collection of mechanisms of federal-provincial interaction.

Conclusion

Joint ventures have been employed by private sector firms for many years to penetrate new markets and to spread the risks involved in developing

new products. By pooling their respective strengths in the makeup of the joint enterprise, the participating firms create a company suitable for the task at hand and stronger than its individual members.

Recent experience in Canada suggests that two or more governments may reap mutual advantages by joining together in a company to deal with a common challenge or problem. Indeed, our fledgling record confirms the additional capacity of the intergovernmental joint enterprise to take in private sector participants.

In the Fishery Products case, the extended joint venture model may have been the only feasible response to an intractable mixture of economic and social concerns. The corporate framework permitted the involvement of the necessary actors in a rescue mission of immense significance to a regional economy. The situation merits careful monitoring as a potentially instructive vehicle for a three-way interaction among the federal and provincial governments and the private sector.

The positive-sum advantages of the joint venture are manifest in the Forintek case study and support the argument that the corporation's operations should be studied further to gauge the possibilities for emulating its progress in other areas where common interests cross over. The integration of private industry research activities is of particular interest. Studies by the Science Council and other advisory bodies have stressed the urgency of better coordination and national commitment to research and development in Canadian business-government circles. Forintek's joint venture format may offer a version of investor federalism that will help achieve those goals.

In the proposal for a national trading corporation, we are at a formative stage of analysis and institutional design. The speculative edge to the exercise is tempered by our country's familiarity with state trading corporations, the attractions of the Japanese experience, and the pressures of international competition. The corporate form may be the only instrument choice for an integrated effort by the federal and provincial governments, especially if (as many argue) the private sector must be included.

At the same time, these preliminary inquiries have revealed grounds for caution and further deliberation. Collaborative efforts invite their own challenges of direction, accountability, focus and free riders.

The persistent failure of provincial and federal governments to establish effective systems of accountability for their own enterprises gives little reason for confidence in their ability or willingness to develop methods of mutual accountability for their joint venture corporations.[108] The advantages of risk dispersion among the participants ought not to cloud the need for accountability and disclosure.

Similarly, care must be taken to ensure that the corporate device is not used to harbour hidden public subsidies to the advantage of private sector partners. Problems may also arise if asymmetrical changes are made to the balance of federalism to the detriment of one or more governments

that are not part of the venture. This situation would compel review of the terms of participation, and might attract the argument that framework legislation is necessary to govern the conditions of multilateral membership in such joint ventures. Such an approach, in turn, could introduce formalisms and delays sufficient to counteract the attractions of the joint venture instrument to the leading partners, particularly private sector co-investors. Joint ventures would then become just intergovernmental committees by another name.

Perhaps the key element to be emphasized is that the joint venture is a separate, distinct organization with its own directors, management and corporate objectives. It is not a club, a voluntary society or a federation of member governments and associate participants.

To consider the potential contribution of the instrument to intergovernmental relations, one must appreciate the delegation of discretionary authority and leverage that must be committed by its participants. This is the essence of any effort to bridge differences, to coordinate efforts and to cooperate in meeting common concerns.

The joint corporate venture may offer an environment hospitable to improved federal-provincial interaction in specific policy areas and in a limited set of circumstances.

Observations and Recommendations

The following points draw together the conclusions and recommendations presented in the separate sections dealing with the division of powers and joint corporate ventures between two or more governments.

Public ownership represents a significant extension of the unclearly delineated spending power held by all governments in Canada, and there is strong evidence that provincial governments are prepared to establish their own corporations to push for local development and other provincial priorities.

This readiness on the part of the provincial governments has collided with the division of powers in a number of fields including banking, transportation, resource development and energy. There is some evidence that provincial hydro authorities and other energy-related companies owned by provinces were set up to claim the federal income tax exemption for corporations whose shares or capital are owned 90 percent or more by the province in question. The significance of tax avoidance is difficult to measure, and the scope of the exemption remains subject in any event to the federal power to alter the *Income Tax Act* to the prejudice of provincial enterprises. The only escape for the provinces would then rest on their advocacy of a very generous tax immunity haven in the *Constitution Act*. The likelihood of success in this direction is questionable and uncertain.

Overall, the significance of the provincial undertakings must be kept in perspective. In the context of the growth of government activities in Canada since World War II, and the variety of other outreach effects of provincial actions, the impact of provincial Crown corporations on the division of powers has been slight.

However, the activation of provincial savings pools poses a situation that merits continued attention, because the magnitude of funds available could dominate equity markets in nationally significant enterprises whose shares are publicly traded. The Caisse proved to be a premature example of a tendency in this direction, but the S-31 debate suggests that Canadian federalism and relations with both levels of government and the private sector would be seriously tested if the Caisse model were aggressively pursued in other provinces. Nevertheless, in the context of the interface with the federal regulatory power, the Caisse experience to date is probably of only marginal significance.

As we observed earlier, the extension of public enterprise has provided additional proof that the formal division of powers means less and less in the dynamics of modern federalism. Instances of public ownership by one level of government in sectors regulated by the other level have confirmed that the practical essence of federalism is the sharing, not the splitting, of powers by its member governments.

Joint venture public enterprises provide a promising vehicle for two or more governments to share powers, pool interests and enjoy positive-sum advantages to deal with common challenges, opportunities or problems.

Canadian experience also suggests that private sector participation may be accommodated to create a viable mixed enterprise. Our federal system is sufficiently supple to bring together the private sector and the two levels of government in a collaborative venture.

The most promising areas for adoption of the joint enterprise approach appear to be research and development, business rescues, foreign trade coordination, megaprojects and hi-tech stimulation. In each of these areas, risk diffusion and entrepreneurial flexibility are requirements well served by the joint venture instrument.

Our support for the collaborative model is tempered by the preliminary character of the Canadian experience. Issues of mutual accountability must be addressed with more cogency and political will if intergovernmental ventures become more pervasive.

Notes

This study was completed in October 1984.

1. A. Tupper and G.B. Doern, "Public Corporations and Public Policy in Canada," in *Public Corporations and Public Policy in Canada*, edited by A. Tupper and G.B. Doern (Montreal: Institute for Research on Public Policy, 1982), p. 27.
2. J.W. Langford, "Public Corporations in the 1980s: Moving from Rhetoric to Analysis," *Canadian Public Administration* 25 (Winter 1982): 619–37.

3. See A. Doerr, "Public Administration: Federalism and Intergovernmental Relations," *Canadian Public Administration* 25 (Winter 1982): 564–79; M.J. Trebilcock et al., eds. *Federalism and the Canadian Economic Union* (Toronto: University of Toronto Press for Ontario Economic Council, 1983).
4. For example, Tupper and Doern, "Public Corporations and Public Policy," pp. 27–28.
5. The leaky B.C. bureaucracy has placed in our hands two memoranda, written in the early 1980s by senior policy advisers, which focus on the new threat posed to the B.C. government's capacity to pursue its own economic objectives. In both memoranda the nefarious employment of public corporations such as Petro-Canada is pictured as an integral part of the Ottawa strategy.
6. These three questions were suggested by discussions in G. Stevenson, *Unfulfilled Union* (Toronto: Gage, 1979), chap. 5; G. Stevenson, "The Political Economy Tradition and Canadian Federalism," *Studies in Political Economy* 6 (Autumn 1981): 184; and R.A. Young, P. Faucher, and A. Blais, "Two Concepts of Province-Building: A Critique," paper presented to the CPSA Annual Conference, Vancouver, June 1983, pp. 36–37.
7. In one of our case studies of a non-profit joint venture (Forintek Canada), the relevant governments are not *legally* members; however, they name members to the board of directors and appear to be subject to all of the significant responsibilities and obligations of membership under Part II of the *Canada Corporations Act*.
8. Tupper and Doern, "Public Corporations and Public Policy," pp. 27–28.
9. See A. Tupper, "Pacific Western Airlines," in *Public Corporations and Public Policy in Canada*, edited by A. Tupper and G.B. Doern (Montreal: Institute for Research on Public Policy, 1982), chap. 8.
10. J.R.S. Prichard with J. Benedickson, "Securing the Canadian Economic Union: Federalism and Internal Barriers to Trade," in *Federalism and the Canadian Economic Union*, edited by M.J. Trebilcock et al. (Toronto: University of Toronto Press for Ontario Economic Council, 1983), chap. 1.
11. See Tupper and Doern, "Public Corporations and Public Policy" and Langford, "Public Corporations in the 1980s."
12. A. Tupper, *Public Money in the Private Sector* (Kingston: Queen's University, Institute of Intergovernmental Relations, 1982), p. 53.
13. Department of National Revenue, Taxation. Interpretation Bulletin, No. IT-347R (September 20, 1982), para. 6.
14. See Gordon Bale, "Reciprocal Tax Immunity in a Federation," *Canadian Bar Review* GIC (1983): 652, 678–81.
15. Ibid. Bale at p. 679 argues that the taxation of Crown corporations by the other level of government is constitutionally possible and therefore takes issue with the suggestion of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements in its *Fiscal Federalism in Canada* (Ottawa: Minister of Supply and Services Canada, 1981), p. 182, that "an amendment to the constitution permitting taxation of Crown corporations may be appropriate" in the event that such corporations "become much more common."
16. For example, in social programs the jurisdictional question came to the fore after being subsumed in the 1960s issues of program expansion and level of service.
17. At least seven pieces of energy legislation were enacted by Ottawa and three Western provinces in the three-month period preceding the January 1974 federal-provincial energy conferences; R.J. Harrison, "Natural Resources and the Constitution," paper prepared for the Canadian Petroleum Law Foundation Research Symposium, Jasper, Alberta, June 7, 1979, p.7. In 1980, the National Energy Program brought forward a number of federal legislative initiatives including Bill C-48, *Canada Oil and Gas Act*, which gave Petro-Canada a 25 percent "back-in" on Canada Lands development, and Bill C-57, which legislated excise and revenue taxes.
18. Peter Foster, "The Power of Petro-Can," *Saturday Night* (October 1981), pp. 55–56.
19. Harrison, "Natural Resources," pp. 30–34.
20. *Alberta Report*, July 25, 1983, p. 12 and August 1, 1983, p. 16. The initial, successful results of drilling were announced in May 1984. *Times-Colonist* (Victoria), May 17, 1984.

21. The theme of lack of control is pervasive in British Columbia; however, the province does have considerable power (under section 109 of the *Constitution Act, 1982*) to control exploitation and conservation of its Crown land resources. For example, suggestions that Petro-Canada is "sitting on" leases seem to neglect the fact that the province can set work requirements on leases. It has been suggested that British Columbia used increases in lease rental payments to encourage work or the return of leases to the Crown through a 1974 amendment to the *Petroleum and Natural Gas Act*. See Dale Jordan, "Petroleum Leasing in British Columbia," in *Mineral Leasing as an Instrument of Public Policy*, edited by M. Crommelin and A.R. Thompson (Vancouver: University of B.C. Press, 1977), p. 250.
22. British Columbia, Legislative Assembly, *Debates*, June 26, 1979, p. 406.
23. Ibid., p. 381.
24. M. Jenkin, "The Prospects for a New National Policy," *Journal of Canadian Studies* 14 (Fall 1979), p. 133.
25. W.T. Stanbury, "Changes in the Use of Governing Instruments by the Federal Government," unpublished manuscript, 1982, p. 17.
26. Bill S-31 was introduced by Senator Olson without consultation of or prior notice to the provincial governments. An accompanying news release from the Department of Consumer and Corporate Affairs (November 2, 1982) noted that "the legislation, effective as of today, is directed mainly at the transportation sector and applies to corporations involved in interprovincial and international pipelines, railways, airlines, shipping, trucking, bus companies and commodity pipelines." S-31 was put together in the Competition Bureau of the Department of Consumer and Corporate Affairs. Finance declined involvement and Transport did not participate in the preparation of the bill.
27. As Tupper cogently observes, "Unintentionally, S-31 evoked debate about two questions which are seldom explicitly fused in Canadian political discourse — the balance between public and private sectors and the division of labour between federal and provincial governments"; A. Tupper, *Bill S-31 and the Federalism of State Capitalism*, Discussion Paper 18 (Kingston: Queen's University, Institute of Intergovernmental Relations, August 1983), p. 34.
28. Ibid., pp. 7–8 and more generally, A. Tupper, "The Alberta Heritage Savings Trust Fund: An Overview of the Issues," *Canadian Public Policy* (Supplement, February 1980), p. 6.
29. Jean Campeau, Caisse General Manager, has been reported on this point as follows: "Especially when the investment is of some size the Caisse must . . . watch out for the interests of all its shareholders. But the Caisse will play this role on the board of companies it invests in 'through representatives designated by it, but coming mostly from the private sector'," *The Globe and Mail*, March 3, 1982.
30. Only after Ontario and federal litigation did the Caisse agree to file insider trading reports. Its annual report for 1982 gave the first authoritative picture of its major equity holdings, *The Globe and Mail*, December 3, 1983.
31. See Wendy Kerr, "Policy Shifts Revives Row over Caisse's Role," *The Globe and Mail*, April 11, 1981.
32. *The Globe and Mail*, November 4, 1982; Stanbury, "Governing Instruments," pp. 21–23; Tupper, *Bill S-31*, p. 5.
33. Later "clarified" by Mr. Campeau: *The Globe and Mail*, December 3, 1983.
34. Tupper, *Bill S-31*, p. 35, aptly concludes: "Perhaps by exposing the complexity of Canada's mixed economy, the storm over S-31 will bring actors' visions more in line with reality. The federalism of state capitalism will not be mastered until its advent is more broadly acknowledged."
35. M.J. Trebilcock and J.R.S. Prichard, "Crown Corporations: The Calculus of Instrument Choice," in *Crown Corporations in Canada*, edited by J.R.S. Prichard (Toronto: Butterworth, 1983), p. 30.
36. *National Transportation Act*, R.S.C., 1970, c. N-17, s. 27.
37. Tupper, "Pacific Western Airlines," p. 289.

38. *Financial Post*, November 2, 1974, p. 9. The White Pass threat seems overstated. The PWA board had rejected the White Pass and Yukon bid and the CTC may not have been supportive of the application, given the loss in competition through the merger of the companies' Yukon trucking subsidiaries.
39. John Richards and Larry Pratt, *Prairie Capitalism: Power and Influence in the New West* (Toronto: McClelland and Stewart, 1979), p. 216.
40. *Alberta Report*, April 26, 1982, pp. 44–45, and Tupper, "Pacific Western Airlines," pp. 294–95.
41. Tupper, "Pacific Western Airlines," p. 296.
42. The federal tune was quite different on the 1981 plan to merge Quebecair with Nordair, a proposal which was killed by the Quebec government when it took a minority interest in Quebecair. A year later, Transport Minister Jean-Luc Pepin was proposing a restructuring of Quebecair with the winding down of a debt-ridden shell and the rebirth of "Quebecair II" jointly owned by Air Canada and the Quebec government (or its nominee). In this case, Air Canada was to have control; however, obviously frustrated at the series of failures, Pepin said that if the Quebec government didn't like the proposal, it could buy out control of Quebecair. While this suggestion would be tempered in practice by the participation of Nordair in many of the same market areas, the subsequent decision to sell Air Canada's Nordair stake (May 1984) could leave a situation quite similar to that in Alberta in 1977. The differences in federal approach are marked. The difference now seems to be that the federal government is in a position of control, issuing dispensations from the application of the relevant acts. See *The Globe and Mail*, November 22, 1982, p. B1; November 24, 1982, p. B5; and June 2, 1984, p. B16. See also Tupper, "Pacific Western Airlines," p. 298.
43. Tupper, "Pacific Western Airlines," p. 311.
44. While under government orders to consider the impact of decisions on smaller carriers in Alberta, PWA's activity, with the acquiescence, if not open support of the minister of transportation, has bordered on unfair competition against small third-level carriers such as Time Air of Lethbridge. The ongoing dispute was resolved only when PWA bought a 40 percent interest in Time Air in the fall of 1983. Ibid., p. 309; and *Alberta Report*, September 26, 1983, p. 71.
45. *Savings and Trust Corporation of British Columbia Act*, S.B.C. 1975, c. 68, Assent June 26, 1975.
46. *Vancouver Province*, May 17, 1975.
47. Section 42 provides, "This Act comes into force on a day to be fixed by Proclamation." The Socred government has never exhibited any interest in establishing B.C. Savings.
48. Walter Stewart, *Towers of Gold — Feet of Clay: The Canadian Banks* (Toronto: Totem, 1983), p. 41.
49. Western Economic Opportunities Conference, July 24–26, 1973, Calgary, "Capital Financing and Regional Financial Institutions," cited in J.N. Benson, *Provincial Government Banks: A Case Study of Regional Response to National Institutions* (Vancouver: Fraser Institute, 1978), p. 12.
50. Ibid., p. 35.
51. Ibid., pp. 24–25.
52. *Savings and Trust Corporation Act*, s. 4(1).
53. Evident from a close reading of Premier Barrett's second-reading speech: British Columbia, Legislative Assembly, *Debates*, May 30, 1975, p. 2887; and Benson, *Provincial Government Banks*, p. 31.
54. British Columbia Energy Commission, *Report on Matters Concerning the Natural Gas Industry in British Columbia* (Vancouver, September 1973), Tab I-23 and Tabs II-1 to II-6.
55. British Columbia, Legislative Assembly, *Debates*, October 23, 1973, p. 854.
56. Ibid., pp. 852–53; and BCEC, *Natural Gas Industry*, Tab III-9.

57. S.B.C., 1973, c. 140.
58. *Vancouver Sun*, December 20, 1980, p. 1. The issue was resolved politically by the September 1981 federal-provincial energy agreements.
59. British Columbia, Ministry of Energy, Mines and Petroleum Resources, *A Report on the Marketing of British Columbia Natural Gas* (Victoria, February 1983).
60. The Ocelot Industries Ltd., methanol plant in Kitimat is in trouble and, if it fails, BCPC as a preferred creditor could enter a much more active phase, ironically much closer to the activities implied in the original NDP legislative mandate. See *The Globe and Mail*, June 7, 1984, p. B9.
61. Parliamentary Task Force on Federal-Provincial Fiscal Arrangements, *Fiscal Federalism in Canada* p. 191.
62. Hon. J.R. Smallwood, *I Chose Canada* (Toronto: Macmillan, 1981), p. 353.
63. S.C. 1970–71–72, c. 63, s. 149(1)(d).
64. Philip Smith, *Brinco: The Story of Churchill Falls* (Toronto: McClelland and Stewart, 1975), pp. 100, 160.
65. S.C., 1968–69, c. 44, s. 14(1).
66. Trebilcock and Prichard, "Crown Corporations," p. 48.
67. A.R. Vining, "Provincial Hydro Utilities," in *Public Corporations and Public Policy in Canada*, edited by A. Tupper and G.B. Doern (Montreal: Institute for Research on Public Policy, 1982).
68. W.A.C. Bennett, "Why I took Over B.C. Electric," *Monetary Times* (November 1961), pp. 20–21, cited in Vining, "Provincial Hydro Utilities," p. 185, n. 53.
69. Vining, "Provincial Hydro Utilities," pp. 174–75.
70. *Financial Post*, November 2, 1974, p. 9.
71. P. Drucker, *Management: Tasks, Responsibilities, Promises* (New York: Harper and Row, 1974), p. 720.
72. Royal Commission on the Economic Union and Development Prospects for Canada, *Challenges and Choices* (Ottawa: Minister of Supply and Services Canada, 1984), pp. 60–63.
73. See R. Simeon "A Summary of Proceedings," in *Confrontration and Collaboration: Intergovernmental Relations in Canada Today*, edited by R. Simeon (Toronto: Institute of Public Administration of Canada, 1979), pp. 1–16.
74. See note 7.
75. This definition is adapted from one used by J. Tomlinson, *The Joint Venture Process in International Business* (Cambridge: MIT Press, 1970). We use joint venture and joint enterprise synonymously, eschewing the distinction made by M. Prince and G.B. Doern, *The Origins of Public Enterprise in the Canadian Mineral Sector: Provincial Case Studies and the National Policy Climate*, a study prepared by the Centre for Policy and Program Assessment, School of Public Administration, Carleton University (Kingston: Queen's University, Centre for Resource Studies, September 1983), chap. 1. A further definitional point is that some entities may look like joint ventures at first glance when they are not. For instance, while the Canada–Nova Scotia Offshore Oil and Gas Board is a "joint" organization with some regulatory and monitoring functions with respect to the Venture Development Project, it is not a corporate enterprise and the two governments do not have a share ownership or a membership relationship with the agency.
76. See J. Langford and K. Huffman, "The Unchartered Universe of Federal Public Corporations," in *Crown Corporations in Canada*, edited by J.R.S. Prichard (Toronto: Butterworth, 1983), pp. 231–32.
77. See C. Eckel and A. Vining, "Toward a Positive Theory of Joint Enterprise," in *Managing Public Enterprises*, edited by W. Stanbury and F. Thompson (New York: Praeger, 1982), pp. 209–24.
78. Widening our net to include joint ventures indirectly held by parent governments would have allowed us to add the following type of corporations to our sample: *Allelix*, a public-private sector partnership owned 50 percent by the Canada Development Corporation, 30 percent by John Labatt Ltd., and 20 percent by the Ontario Develop-

ment Corporation through its BILD (Board of Industrial Leadership and Development) program; *Key Lake Mining Ltd.*, a joint enterprise owned 50 percent by the Saskatchewan Mining Development Corporation, 25 percent by Eldor Resources Ltd. (a subsidiary of Eldorado Nuclear Ltd.), and 25 percent by Uranez Exploration and Mining Ltd. (a German-controlled firm).

79. See Peter Cook, *Massey at the Brink* (Toronto: Collins, 1981); D. Francis, "Bailing out the Titanic," *Canadian Business* (June 1981), pp. 47ff.; and *Macleans* (May 23, 1983), p. 44.
80. *Canadian Business* (March 1982), pp. 104ff.
81. See L. Pratt, *The Tar Sands: Syncrude and the Politics of Oil* (Edmonton: Hurtig, 1976); and Peter Foster, *The Blue-Eyed Sheiks: The Canadian Oil Establishment* (Toronto: Collins, 1979), especially chap. 6.
82. J. Stefan Dupré, "Reflections on the Workability of Executive Federalism," the first paper in *Intergovernmental Relations*, volume 63 of the research studies prepared for the Royal Commission on the Economic Union and Development Prospects for Canada (Toronto: University of Toronto Press, 1985).
83. Canada, Task Force on Atlantic Fisheries, *Navigating Troubled Waters: A New Policy for the Atlantic Fisheries, Highlights and Recommendations* (Ottawa: Minister of Supply and Services Canada, 1982), p. 140 (henceforth cited as Kirby Report, *Highlights*.)
84. Robert L. Mansell and Lawrence Copithorne, "Canadian Regional Economic Disparities: A Survey," in *Disparities and Interregional Adjustment*, volume 64 of the research studies prepared for the Royal Commission on the Economic Union and Development Prospects for Canada (Toronto: University of Toronto Press, 1985).
85. Canada, Department of Fisheries and Oceans, "Atlantic Fisheries Restructuring," November 22, 1983, pp. 1, 8. The job impact in Newfoundland is reported as 15,000.
86. Kirby Report, *Highlights*, p. 142.
87. The enabling federal financial legislation, Bill C-170, section 6(2), provides for up to $100 million in loan guarantees. This rather open-ended facility is not supposed to be used for the restructured companies but rather reserved for other enterprises "subject to policy decision by the government." See Canada, Department of Fisheries and Oceans, "Atlantic Fisheries," pp. 13–14.
88. Kirby Report, *Highlights*, p. 141.
89. Canada, Department of Fisheries and Oceans, "Atlantic Fisheries," p. 9. Many of the nationalization fears are based on concern at government movement into marketing arrangements. See the presentation of the Fisheries Council of Canada to this Royal Commission, September 22, 1983, p. 5.
90. *Agreement between the Government of Canada and the Government of Newfoundland and Labrador Concerning the Restructuring of the Newfoundland Fisheries*, September 26, 1983, p. 6, and Canada, Department of Fisheries and Oceans, "Atlantic Fisheries," pp. 11–12.
91. *ForesTalk Resource Magazine* (Spring 1983), p. 11.
92. R.S.C. 1970, c. C-32.
93. For a discussion of rationales for state intervention in the allocation of resources to scientific R&D see D.G. McFetridge, *Government Support of Scientific R&D* (Toronto: Ontario Economic Council, 1977), chap. 1.
94. Canada, House of Commons, Standing Committee on Fisheries and Forestry, *Report*, No. 10, November 27, 1979, p. 34.
95. *The Globe and Mail*, March 12, 1979.
96. See Y. Tsurumi, *Sogoshosha: Engines of Export-Based Growth*, rev. ed. (Montreal: Institute for Research on Public Policy, 1983), especially chap. 8.
97. Canada, House of Commons, Special Committee on a National Trading Corporation, *Fourth Report*, Introduction (Ottawa: Minister of Supply and Services Canada, 1981).
98. B. Popp, "The Role of a Provincial Trading Corporation in B.C.," Management Report (Victoria: University of Victoria, School of Public Administration, February 17, 1982).
99. See C.J. McMillan, "A National Export Trading House," *Canadian Public Policy*

3 (Autumn 1981): 569–83.

100. Canada, House of Commons, Special Committee, *Fourth Report*, chap. 5.
101. One can hardly suppress the urge to add the infamous uranium cartel to this list. While distinctly "informal" in structure, it enjoyed the status of involving private sector participants in the undertaking.
102. See J.K. Laux and M.A. Molot, "The Potash Corporation of Saskatchewan," in *Public Corporations and Public Policy in Canada*, edited by A. Tupper and G.B. Doern (Montreal: Institute for Research on Public Policy, 1982), p. 200.
103. Canada, Department of External Affairs, *Canadian Trade Policy for the 1980s: A Discussion Paper* (Ottawa: Minister of Supply and Services Canada, 1983); P. Proulx, "Trade Liberalization and Industrial Adjustment Policy for Canada" paper prepared for the Canada–U.S. Trade Relations Conference, Provo, Utah, March 30, 1984; A. Raynauld, J.-M. Dufour, and D. Racette, *Government Assistance to Export Financing*, study prepared for the Economic Council of Canada (Ottawa: Minister of Supply and Services Canada, 1983).
104. See Tsurumi, *Sogoshosha*; McMillan, "National Export Trading House."
105. Canada, House of Commons, Special Committee, *Fourth Report*, chap. 6.
106. A. Tupper, *Public Money*, p. 7.
107. Tupper and Doern, "Public Corporations," p. 19.
108. The Australian experience with systems of mutual accountability for intergovernmental statutory authorities provides some grounds for optimism. See R.L. Wettenhall, "Quangos, Quagos and the Problems of Non-Ministerial Organization," in *Quangos: The Australian Experience*, edited by G.R. Curnow and C. Saunders (Sydney: Hale and Iremonger, 1983), pp. 41–42.

Municipalities and the Division of Powers

JACQUES L'HEUREUX

Introduction

A municipality may be defined as a political body formed by the residents of a particular region and having powers of a local nature that it can exercise autonomously. The existence of a municipality, therefore, assumes first, a specific geographic region and, second, that this region is governed by its residents who elect people to represent them. Furthermore, it assumes powers of a local nature. And finally, it assumes a degree of autonomy which allows the municipality to exercise its powers, or at least a majority of them, freely, without outside supervision, and which grants it the financial means to do so — that is, its own sources of revenue.

The first Canadian municipal institutions date back to September 20, 1663, when the Conseil souverain de la Nouvelle-France adopted a decree calling for the election of a mayor and two aldermen for the City of Quebec.[1] These institutions did not last long, however.[2] Another attempt at establishing municipal institutions for the City of Quebec in 1673 was also a failure.[3]

The first general structuring of municipal institutions dates from 1793, when Upper Canada passed the *Act to provide for the nomination and appointment of Parish and Town Officers within the Province*.[4] These municipal institutions, while still rudimentary, were the source of Canada's present municipal institutions.

In Lower Canada, the first overall structure for municipal institutions dates back only to 1840.[5] It should be noted, however, that the City of Quebec and the City of Montreal were both chartered in 1831.[6]

Today, every Canadian province has municipal institutions. But while there are three levels of government in the country — federal, provincial and municipal — only the first two are protected by the Constitution.

We will examine the problems resulting from the division of powers under the Canadian Constitution with respect to the municipal sphere and propose solutions or at least ways of reducing these problems. We will look in turn at the substructure of municipal institutions, provincial powers, federal powers and the status of municipalities.

The Substructure of Municipal Institutions

Before the various proposals for solving the problems of municipalities relative to the division of powers can be examined, it is essential to describe the substructure and the purpose of municipal institutions. The relative value of a proposal will necessarily depend on the notion of a municipality and of its democratic base.

Municipal institutions serve a two-fold purpose. First, they must efficiently provide certain services to residents. Secondly, they must allow residents of a specific region to administer their own local affairs autonomously.[7]

The first purpose is administrative in nature. Since a local government can adapt certain services to local preferences and needs, it is better able to provide them efficiently.

The second, more basic, purpose is political in nature. A group of people endowed with political authority is autonomous with respect to matters over which it has jurisdiction and thus it is not constantly controlled by other administrative authorities. It can be distinguished from other municipalities by its options and its priorities. As a result, citizens can choose from neighbouring municipalities the options, priorities and services that best meet their personal preferences.[8] The municipality is a source of local initiative and independence: it allows the people of the place to be represented.

Popular participation is an essential objective in a democratic country like ours, all the more when in Canada at the end of the 20th century the opportunity for such participation in the federal and provincial levels of government is rather limited. The vast administrative structures that exist at these levels leave little room for elected officials or democracy in operations that are remote and inaccessible. Since the tendency of those in power is, unfortunately, to seek continually to increase it and to think that they are superior beings with a monopoly on truth and competence, these administrative structures tend to bring everything under central control.

The desire to participate, belong and have a role to play in the community expands as people become better educated, but the populace has little hope of participating in decision making and even less of being able to influence decisions significantly. The citizen's feelings of impotence and frustration in this regard would forever increase were it not for municipalities, which act as counterweights to this vast structure.

Although Canada is one of the most democratic countries in the world, participation by her people in provincial and federal government is limited to voting every four or five years for a party and, above all, for a prime minister who, if his party has an absolute majority, will govern rather like a king with the aid of a few ministers, advisors and senior civil servants. Fundamental freedoms do exist, of course; there are free elections when the people can dismiss their "monarch." And the opposition can play its part. Nevertheless, one wonders whether this sort of democracy is still adequate. It originated in an era when the populace was relatively uneducated, communications were less efficient and technology more primitive, an era when members of Parliament had a much more important role to play. One is left to wonder whether democracy as we know it should not be completely rethought.

On the municipal level, however, popular participation remains possible. Municipalities offer a level of representation as great as that of the other two levels of government. The members of municipal councils are elected, just as federal and provincial legislators are, so that the municipalities represent a very strong political force, a fact of which they have not always been sufficiently aware. The political power of large cities in particular is quite substantial, given their populations and economic strength. It is worth noting that 25 Canadian cities have larger populations than the country's smallest province.[9]

There have been claims that municipal institutions are anti-democratic. The explanation has been that they promote diversity, whereas democracy demands equality among all and the triumph of the majority.[10] This is not a very persuasive argument.[11] Equality of this sort is not true equality at all, but the dictatorship of the majority, of the 51 percent over the 49 percent. It is the negation of minority rights and of the freedom of individuals to live as they choose. On the other hand, true equality assumes freedom, respect for minorities and the right of individuals to choose their way of life.

It is reasonable for services to vary from one municipality to another, so long as the basic essential services are available. The needs of different municipalities are not the same. It is normal for a big city to offer more services than a small town, and the preferences of the residents can vary from one municipality to another. The demand for services depends on the municipality and on such factors as the density and age of the population, the degree of urbanization, the physical features of the community and the preferences of individuals.[12]

Municipalities are sometimes accused of incompetence, of corruption, and of parochiality,[13] but there are no serious studies on which to base such accusations. They seem to be part of a folklore which reassures the centralizers of all kinds and reinforces them in their quiet, highly undemocratic conviction that they are alone in their competence, honesty and

broadmindedness and that, as a result, they deserve to have control and keep close watch on other officials. Such accusations allow both federal and provincial centralizers to avoid making the effort of imagination and collaboration that a decentralized system requires. The irony of the situation is not noticed by some provincial politicians and officials who strongly criticize the federal authorities for being overly centrist but are themselves very centrist when it comes to the municipalities.

In October 1979, the tenth national symposium of the Institute of Public Administration of Canada, on "The Municipal Government in the Intergovernmental Labyrinth," concluded, among other things, that compared to the situation ten years before, "the theory that said municipal elected officials and employees were essentially incompetent and incapable of valid analysis or decision making" had been "left behind," whereas it had once "seemed to enjoy broad support."[14] In fact, it is by no means certain that the average competence of municipal officials on the job is any less than that of federal and provincial legislators, nor that the average competence of mayors of large cities is any less than that of federal and provincial ministers. Likewise, the competence of government employees at work in large cities seems comparable to that of federal and provincial officials. If the employees of the smallest municipalities are not always so competent, it is worth remembering that they have local, less complex problems to deal with than their federal and provincial counterparts. And they do have the advantage of being close to the people.

The occasional accusations of widespread corruption among municipal authorities will not be answered here. While there have been a few isolated cases of corruption in Canada's more than 2,600 municipalities, there has never been any evidence of its spreading.

As for the charge of parochialism, the recent history of relations between federal and provincial governments provides ample proof that smallmindedness is not restricted to local officials. Nor is there any need to exaggerate its importance.

In conclusion, let us stress the importance of our municipalities as a means of ensuring popular participation in government. As the most accessible level of government, the municipalities are closest to those on whose everyday lives they impact. Municipalities enable their residents to settle their own local problems, to establish the services that correspond to their own needs and to obtain the quality of life that corresponds to their preferences. In any case, local problems are more easily and effectively solved by local authorities. If, in principle, a unitary state should seem more efficient, the facts suggest the contrary. There are too many examples of inappropriate regulations, poorly resolved problems, and plainly bad decisions that result from a remote decision-making centre. Municipalities are particularly important to Canada, given the size of the country and the diversity of its people.

Provincial Jurisdiction

We will first examine the general jurisdiction of provincial legislatures with respect to municipal institutions, then consider the delegation of powers to municipalities.

General Jurisdiction

Section 92 of the *Constitution Act, 1867* provides that "In each Province, the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subjects next herein-after enumerated; that is to say, — 8. Municipal Institutions in the Province." Under the same section, "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes."[15] "Shop, Saloon, Tavern, Auctioneer, and other Licences in order to the raising of a Revenue for Provincial, Local or Municipal Purposes,"[16] "Property and Civil Rights"[17] and "Generally, all Matters of a merely local or private Nature in the Province."[18]

Provincial legislatures, therefore, have exclusive jurisdiction in the matter of municipal institutions.[19] Only they can create municipal institutions and only they can control the municipal institutions they have created.

Delegation

Provincial legislatures may delegate to municipalities powers that are under provincial jurisdiction. What about powers under federal jurisdiction or instances of delegation of power that would affect the operation of federal powers?

Powers Under Provincial Jurisdiction

We will look first at the right of provincial legislatures to delegate powers within their jurisdiction to municipalities, and then at the question of the regard or disregard of municipal autonomy in exercising this right.

The Law

Since they are sovereign within their jurisdiction, provincial legislatures may delegate any power under their jurisdiction to their municipalities.[20] The decision of the Privy Council in *Hodge v. The Queen* is clear on this subject. Sir Barnes Peacock states:

> When the British North America Act enacted that there should be a legislature for Ontario, and that its legislative assembly should have exclusive authority to make laws for the Province and for provincial purposes in relation to the matters enumerated in sect. 92, it conferred powers not in any sense to be

> exercised by delegation from or as agents of the Imperial Parliament, but authority as plenary and as ample within the limits prescribed by sect. 92 as the Imperial Parliament, in the plenitude of its power possessed and could bestow. Within these limits of subjects and area the local legislature is supreme, and has the same authority as the Imperial Parliament, or the Parliament of the Dominion, would have had under like circumstances to confide to a municipal institution or body of its own creation authority to make by-laws or resolutions as to subjects specified in the enactment, and with the object of carrying the enactment into operation and effect.[21]

In *Outdoor Neon Displays v. City of Toronto*,[22] the Ontario Court of Appeal decided that a provincial legislature may not delegate to a municipal commission the power to declare valid any municipal by-law on a particular subject. The grounds given were that only the provincial legislature possesses and can exercise the right to confer powers on a municipality. This decision could be interpreted as prohibiting a provincial legislature from delegating to a municipality or to another authority powers other than limited powers that must be exercised as required by general principles or guidelines issued by the legislature itself.[23] This is not a very persuasive decision, however, because it contravenes the sovereignty of provincial legislatures and *Hodge v. The Queen*. Furthermore, delegation of powers does not constitute an abdication of these powers because a legislature can always reclaim the powers it has delegated. It should also be pointed out that *Outdoor Neon Displays v. City of Toronto* was not a unanimous decision and that it is the only Canadian decision to set out this theory.[24] The judgment was confirmed on appeal by the Supreme Court of Canada for another reason, but the Court explicitly refused to rule on this aspect of the question.[25]

Municipal Autonomy

Provincial legislatures have most of the powers required to create good municipal systems and they have done so, providing them with relatively extensive autonomy.

However, municipal autonomy has been declining in recent years, and provincial legislatures have withdrawn some powers from their municipalities, particularly in the fields of housing, the environment, zoning of farmland and social security. Moreover, municipalities are subject to a growing number of controls by provincial departments or agencies.[26]

While the problems of municipalities, particularly their financial problems, might be resolved by accelerating this trend and transferring other powers to provincial bodies or provincially created agencies, such a practice would have harmful consequences, both for democratic and administrative reasons, because it would be contrary to the basic principle of municipalities.

Better to give to the municipalities the powers and the autonomy they need to carry out their functions. It would not imply significant increase

of their powers. It would imply, however, the elimination of any local agencies created by provincial legislatures for local purposes and the reinvestment of their powers in the municipalities which, in turn, should be able to create and control their own agencies.[27] A reduction of numerous controls by provincial departments or agencies would also follow, in deference to municipal autonomy. Finally, for the benefit of the public, and public information, the powers would have to be divided clearly.

It is obviously necessary for the large municipalities to have greater powers in some areas, given their special nature. Various regional municipalities have already been created by provincial legislatures in order to satisfy regional needs more easily. They are particularly useful in areas near large cities. As regards the large cities themselves, it is obviously necessary for them to have greater powers in some areas, given their special nature. In our opinion, the local municipality should nevertheless remain the basic unit because it can most conveniently carry out its duties, particularly its participatory function. The area covered and sheer size of the population of the regional communities already make popular participation more difficult, and the difficulty increases when regional-municipality councillors are not directly elected by residents.[28]

Powers Under Federal Jurisdiction

We will first look at whether provincial legislatures can delegate federal jurisdictional powers to municipalities. Then we will discuss the particular problems of municipal by-laws affecting the operation of federal powers.

The Law

Provincial legislatures can delegate to their municipalities only those powers that come under provincial jurisdiction. They cannot delegate powers they do not themselves have. In *A.-G. Ont. v. A.-G. Can., Re Prohibitory Liquor Laws Case*,[29] the Privy Council rejected the old jurisprudence on this subject which stated that provincial legislatures could delegate to their municipalities the powers of exclusive federal jurisdiction which they had before the *Constitution Act, 1867*, giving as its reason that the words "Municipal Institutions" in head 8 of section 92 of the Act meant municipal institutions that existed before Confederation.[30] The Privy Council correctly rejected this notion because a law must be read as a whole, and the reference to municipal institutions in head 8 of section 92 could not be intended to interfere with the division of powers that the law itself provides.

Provincial legislatures thus cannot delegate to their municipalities any powers that are exclusively under federal jurisdiction. This applies, for example, to criminal law[31] or matters involving aviation or aerial navigation.[32] Nor may a municipality pass by-laws on such subjects.[33]

By-laws Affecting Operations of Federal Powers

According to the precedents, a municipal by-law cannot affect the essential nature of an operation under federal jurisdiction.[34] According to the jurisprudence, a municipality may not use its control over zoning, for example, to prohibit airports in a particular portion of its territory.[35] Likewise, it cannot oblige a company operating an interprovincial telephone service to observe municipal by-laws about erecting poles and lines in the streets of the municipality.[36] Nor can it oblige a federal company to obtain an operating permit to do business in the municipality.[37] This is not the case, however, when the essential nature of the operation of federal power is not affected.[38] Thus, the provisions of municipal regulations on the maintenance of ditches are applicable to a federal railway company.[39] Likewise, a zoning by-law can be applied to land belonging to a national port commission if it does not prohibit or regulate the use of this land for purposes of navigation.[40]

It is reasonable for a municipal by-law not to affect the essential nature of an operation under federal jurisdiction, but one wonders if the precedents do not occasionally go too far;[41] for example, when it is held that, because of the jurisdiction of the federal Parliament over aviation, federal authorities can build an airport without observing local planning ordinances.[42] Ottawa does indeed have jurisdiction over aviation, but not over zoning. As a result, would it not be logical for federal powers to have to respect provincial laws and municipal by-laws on zoning but not on matters of aviation?

Surely, the setting aside of provincial laws and municipal by-laws in areas of provincial jurisdiction as soon as federal authorities wish to exercise some federal power is contrary to the spirit of federalism, the division of powers and the harmony of legislation. If provincial laws and municipal by-laws prevent the construction of an airport at a particular location, would it not be logical and consistent with the division of powers for the federal authorities also to be barred from building at that site? If federal authorities were then to build at a less advantageous location, the provincial authorities would bear the consequences. Federal authorities might even abandon plans for the proposed airport. Yet, the sites selected by federal authorities for large airports in recent years have by no means always been fortunate and, in the case of Mirabel airport, for example, respect for provincial and municipal jurisdictions might well have produced better results.

On the other hand, if provincial laws or municipal regulations were to completely prevent the exercise of a federal power, for example prohibiting the construction of an interprovincial pipeline, federal authorities should not be subject to them and should not be prevented from exercising their powers.

Federal Powers

We will first look at the federal Parliament's absence of jurisdiction over municipal institutions, then consider the immunities and powers that nevertheless allow it to play an important role in this area. Federal immunity touches on federal property, the indirect powers of intervention, the declaratory power and the power to spend. We will then examine whether the federal government can delegate powers to the municipalities and, finally, discuss the question of creating a federal Department of Urban Affairs.

Lack of General Jurisdiction

Even though the federal Parliament has no jurisdiction over municipal institutions, it still has immunities and powers that allow it to intervene in the municipal sphere. In fact, it has intervened often and extensively in this area.[43] In 1973, it was calculated that a total of 219 federal programs, administered by 27 departments, affected urban development in a significant way.[44]

It would be unrealistic to think of granting powers of additional intervention or even general jurisdiction of municipal matters to the federal Parliament, because such a step would require an amendment to the Constitution authorized by resolutions adopted by a majority of the members of the Senate, the House of Commons and the legislative assemblies of at least two-thirds of the provinces, representing at least 50 percent of the population of all the provinces.[45] It is certain that it would be impossible to obtain the consent of the legislative assemblies of such a majority of provinces,[46] but even if it were obtained, the amendment would not take effect in any province whose legislature had expressed its disagreement in a resolution adopted by a majority of its members before the proclamation of the amendment by the Governor General.[47]

Such a solution would not be desirable in any case. Because the municipalities have local powers, it is logically and practically preferable for them to continue to be accountable to provincial legislatures.[48] The establishment of harmonious relations among the three levels of government and the effectiveness of each of these levels assume a logical and clear division of powers. An increase in the powers of the federal Parliament in this area would be contrary to such a division. It would make things more, rather than less, complicated and would be a considerable source of conflict.

Federal Property

The federal Parliament has exclusive jurisdiction over federal property.[49] According to the jurisprudence, it is not subject to municipal regulations

on its lands and properties, and in particular, to urban planning regulations.[50] It can do whatever it wants. Moreover, the jurisprudence has allowed that the federal Parliament had the power to create a National Capital Commission and to give it powers over the development and improvement of the National Capital Region, even though its powers directly affect only its own land.[51]

Precedents on questions of federal property significantly restrict the jurisdiction of provincial legislatures. The federal Parliament is in fact the leading landowner and builder in Canada, and its lands and properties are considerable. Federal properties are always increasing in number and size, particularly with the government's power of expropriation,[52] which it uses frequently and often to excess. For example, there were excessive expropriations made at Mirabel, where some 7,000 hectares were expropriated for the actual airport and another 29,000 hectares for a buffer zone.

In some areas where its landholdings are vast, intervention by the federal Parliament is particularly important. This applies to the national parks[53] and also to the National Capital Region, where the influence of the National Capital Commission is evident.

It is regrettable that, following the jurisprudence, the federal Parliament is not subject to provincial laws or municipal regulations on its lands and properties. Since the division of powers is part of our federal system by definition, it is not logical to suspend it just because federally owned property is involved. On the contrary, it would be much more logical for federal authorities to be subject to the same provincial laws and municipal regulations as other landowners. In fact, the current situation is harmful to provincial and municipal planning. In regions where federal holdings are especially large, it may even prevent real planning.

Buildings belonging to the Crown or to one of its agents are exempt from municipal taxes.[54] This exemption does not affect compensation which must be paid for particular services, since the compensation is the price of the service and not a tax in the strict sense of the word.[55]

Indirect Powers of Intervention

The federal Parliament can intervene indirectly in municipal matters by exercising its jurisdictional powers; thus, its impact will be felt with respect to interprovincial pipelines, interprovincial telegraph and telephone lines, Indian reserves, transport and criminal law. For example, consider the effects of setting up a port, a railway or an airport. At Mirabel, the construction of an airport meant that the neighbouring communities had to be completely reorganized as a result of the land expropriations and consequent economic upheavals.

Let us not forget that municipal by-laws cannot affect the course of these matters of federal jurisdiction.

Declaratory Power

Declaratory power allows the federal Parliament to acquire jurisdiction over works located entirely in one province on declaration that they are to the greater advantage of Canada or of more than the one province.[56]

This declaratory power is contrary to the spirit of federalism and the division of powers. It should be rescinded or at least substantially limited.[57]

Power to Spend

According to most legal interpretations[58] and a decision by the Ontario Court of Appeal,[59] the power to spend allows the federal Parliament to spend even in areas where it does not have jurisdiction; this includes the distribution of grants and loans in areas of provincial jurisdiction according to its own conditions.

The federal Parliament has used this power widely and often in order to intervene directly in municipal affairs. It will serve to mention the activities of the Department of Regional Economic Expansion[60] and, in housing and urban renewal, the intervention activities of the Canada Mortgage and Housing Corporation,[61] whose assets in 1981 amounted to $10.797 billion.[62]

The power to spend, as so interpreted, should be substantially limited. It should not be used by Ottawa to intervene directly in municipal affairs by offering grants or conditional loans in areas of provincial jurisdiction.[63]

The interpretation given to this power is contrary to federalism and the division of powers set down by the Canadian Constitution. By imposing its own terms for awarding grants or loans in matters under provincial jurisdiction, the federal Parliament is taking control in these areas, ultimately single-handedly establishing major lines of policy. Provincial legislatures, having the jurisdiction under the division of powers, become simple executors of federal policy. The federal Parliament has thus, in effect, amended the division of powers established by the Constitution.

As so interpreted, this power also denies the equality of the federal Parliament and the provincial legislatures. Yet, equality and respect for the division of powers are necessary if there is to be adequate representation of all Canadians, given the size of the country and the diversity of its people.

As so interpreted, this power is contrary to the accordance of laws among the various levels of government because it allows one level to block the established division of powers.

Implementation of this federal power has had harmful administrative consequences, given the complexity of the operations needed to carry it out and its distance from the real decision-making centre.

The Castonguay Report stated, justifiably:

> Even if each federal intervention viewed in isolation may appear to be merited and valid according to a particular dynamic or point of view, it is nevertheless true that these interventions taken as a whole which have resulted in making the federal government omnipresent in urban and local affairs in Quebec, can only be considered ominous. It cannot be forgotten that cities are the expression of the economic and social organization which a society develops to attain its goals. Quebec society has insisted on determining this framework in the past by itself, and despite the weaknesses it may contain, it is essential that our society be able to continue to assume this fundamental responsibility in the future.[64]

While made in the context of Quebec, these remarks are also valid for the other provinces.

It is far from certain that the interpretation of the spending power under this theory by the majority and by the decision of the Ontario Court of Appeal would not be abridged by the Supreme Court of Canada, which has yet to pronounce on this issue.[65] It should be noted that the Privy Council gave an opinion favourable to such a limitation in *A.-G. for Canada v. A.-G. for Ontario, Unemployment Insurance Reference*.[66] In fact, Lord Atkin stated that when the federal government created a fund through a tax, "it by no means follows that any legislation which disposes of it is necessarily within Dominion competence. It may still be legislation affecting classes of subjects enumerated in s. 92, and, if so, would be ultra vires."

Delegation

According to the precedents, the federal Parliament cannot delegate any of its exclusive powers to the provincial legislatures, nor can the provincial legislatures delegate any powers from their exclusive jurisdiction to the federal Parliament.[67] Under the jurisprudence, such delegation would modify the division of powers established by the Constitution.[68]

The federal Parliament, which is competent to select the persons or agencies to whom it wishes to entrust the execution of its laws, can, according to the jurisprudence, delegate powers under its exclusive competence to a commission, a board or a provincial body.[69]

It might be claimed that this jurisprudence is not applicable to municipalities because they are local groups and are expressly stated to be within exclusive provincial competence under the *Constitution Act, 1867*. However, municipalities, like provincial commissions, boards and bodies, are institutions created by the provinces. It seems, therefore, that this jurisprudence can be applied to them and that the federal Parliament can delegate to them powers from its exclusive jurisdiction.[70] There is an Ontario judgment, supporting the possibility of such delegation,[71] that predates the precedents on the delegation to provincial agencies.

According to the Ontario judgment, delegation can take place only if the provincial legislature gives its consent. Since municipalities are created by provincial legislatures, they can have only the powers the latter have given them or authorized them to use.[72] For the same reason, a provincial legislature could, in our opinion, prohibit its municipalities from accepting loans or grants from the federal Parliament.[73]

A Federal Ministry of Urban Affairs

Canada had a Department of State for Urban Affairs from 1971 to 1979, its responsibilities being the formulation and extension of policy lines for federal Parliament activities in the area of urban matters.[74] The experiment was not successful and the department finally abolished.[75]

The creation of a federal department of intergovernmental affairs, its mandate to ensure communication among the three levels of government, has been proposed.[76] But such a department seems inadvisable to us because it would give the federal government a dominant role in municipal affairs and increase its opportunities for intervention. Municipalities are under provincial jurisdiction and it is desirable for them to remain so. In any case, such a department would only replace the unsuccessful Department of State for Urban Affairs.

There have also been suggestions that a federal information agency on urban and regional affairs be created.[77] Such an agency would be beneficial if its work were limited to federal jurisdiction, i.e., to indirect intervention resulting from the exercise of its powers. On the other hand, such an agency would be harmful if its work were to cover all municipal affairs, which are under provincial jurisdiction and should, we believe, remain so. However, the provincial governments could effectively form an interprovincial agency for this purpose.

The Municipalities

We will first look at the nature of the powers of municipalities, the exercise of those powers and municipal financing. We will then question whether there should be constitutional protection for municipal institutions, and whether the main urban centres of the country should become veritable provinces. Finally, we will examine the question of whether there should be tripartite meetings between federal, provincial and municipal authorities.

The Nature of the Powers

The Canadian Constitution guarantees neither the existence of municipal institutions nor the autonomy of municipalities.

Since provincial legislatures have exclusive jurisdiction over them, they can ascribe more or less importance and more or less autonomy to their

municipalities. They can increase or decrease municipalities' powers and they can modify their territorial boundaries as they see fit.

Legally, a provincial legislature could even completely eliminate municipal institutions in its province.[78] In *Brandon v. Municipal Commissioner for Manitoba*, Adamson, J. stated: "It is not obligatory on the province to have municipalities and municipal institutions, and had such institutions never been brought into being all their powers would be in the provincial Government."[79] However, politically speaking, it seems unthinkable for a provincial legislature to abolish its municipal institutions completely.

The fact that municipalities draw their existence and their powers from the goodwill of provincial legislatures and not from the Constitution has a very significant effect on the nature of those powers.

First of all, unlike the other two levels of government, municipalities have no power in their own right. They have only the powers expressly delegated to them or which directly result from the powers expressly delegated to them. Each of their acts must be based on a legislative provision. Otherwise, the courts will annul it on the grounds that the municipality has exceeded its powers.[80] As a result, municipalities have little room to manoeuvre.

Secondly, since they have only delegated powers, municipalities cannot in turn delegate these powers to others without express legislative permission unless they are powers of a ministerial nature.[81] Here, too, the municipalities have little room to manoeuvre.

Finally, whereas the federal Parliament's and provincial legislatures' powers to legislate are limited only by the Constitution, municipal by-laws can be rescinded because they were passed for improper reasons and irrelevant considerations, were discriminatory, in bad faith or irrational.[82] They can also be annulled for failing to observe procedural rules laid down by legislation.[83] This strict control by the courts greatly limits municipal autonomy and the room for manoeuvre that municipal officials, like federal and provincial elected officials, should have.[84]

Exercise of Powers

Municipalities play an important role in economic matters by reason of their powers involving land use, city planning and taxation. Moreover, the services they offer are essential to economic activity and for its support. In addition, the creation and administering of these services contributes directly to economic activity and employment.[85] The municipalities contribute to economic activity in their search for investments as well, particularly when they set up local industrial development agencies and create industrial funds. According to a 1979 study by the Conference Board, the decision-making factors in industrial site selection are:[86]

Factors	Frequency (%)
Availability of specialized manpower	8.9
Access to markets and suppliers	8.9
Cost of energy	7.7
Quality of life	7.1
Labour relations	7.1
Local and other taxes	6.5
Transport	5.9
Profitability	5.9
Customer requirement	5.9
Government-business relations	5.3
Managerial needs	4.7
Cost of land	3.6
Local growth capacity	3.5

In 1982, municipal employees numbered more than 287,000, or nearly 25 percent of employees in the public sector in Canada. Their total wages were more than $5 billion.[87]

Municipalities do, however, have some serious problems, as we have seen. They have not only lost some powers to provincial authorities or agencies created by provincial legislatures but they are also subject to increasingly strict controls by these authorities and agencies.[88] Having lost some of their room for manoeuvre and autonomy, their decision-making processes have become much more cumbersome. In addition, the municipalities do not have sufficient revenues of their own to satisfy their needs and exercise their powers. Finally, they are often the victims of endless and unproductive quarrels between the federal and the provincial governments.

Financing

Expenditures by Canadian local governments in 1982 amounted to nearly $33 billion. They represented more than 9 percent of the country's gross government expenses.[89]

The Canadian provincial legislatures, however, have not given their municipalities the autonomous tax sources which would allow them to collect the amount of money they need. To fulfil their obligations, the municipalities must depend on grants from the other two levels of government.

These grants have been substantial. Indeed, they account for nearly half of all Canadian local government revenues. In 1982, in all of Canada, 46.3 percent of the revenues of local governments came from grants, or a total of $15.6081 billion.[90]

In 1982, total annual revenues of Canadian local governments amounted to $33.747 billion. They can be broken down as follows:[91]

	Millions of $	Percent
Property taxes[92]	10,840.9	32.1
Business taxes	1,237.4	3.7
Other taxes	283.2	0.8
Total taxes	12,361.5	36.6
Grants in lieu of taxes	945.0	2.8
Other revenues from independent sources	4,832.5	14.3
Government grants	15,608.1	46.3
Grand Total	33,747.1	100.0

We will look first at the grants to municipalities and then at their independent sources of revenue.

Grants

For a very large portion of their income, municipalities must depend on both conditional and unconditional grants from both levels of government.[93] Let us first examine whether grants are an acceptable form of financing and a satisfactory solution to the financial problems of municipalities. Then we will take a closer look at provincial and federal grants.

Grants as a Form of Financing

Municipal autonomy presupposes sufficient financial autonomy for municipalities to exercise their powers and satisfy their needs. In fact, power without the ability to finance it is theoretical power at best. Financial responsibility must therefore balance the political role of the municipalities.

Grants, whether conditional or unconditional, cause municipalities to lose some of this financial responsibility. They are inclined to spend much more freely money that they have not raised by taxes and for which they are not directly accountable to their electorate. They also risk becoming dependent on federal and provincial authorities to solve their problems. Furthermore, grants contain an element of uncertainty that makes long-term planning practically impossible. Such funding can be reduced or stopped altogether from one year to the next. In housing and urban renewal, there are many examples of federal and provincial programs that came to an abrupt halt. Furthermore, municipalities often receive very late confirmation of the funds they are to be awarded. Finally, even unconditional grants can constitute leverage on municipalities if there is talk of their elimination or change of status.

Conditional grants, which are much more substantial, lead to even more damaging consequences. They mean an effective loss of power for municipalities. The federal Parliament or provincial legislature which awards a conditional grant imposes its own standards and conditions on the municipality, which then loses control of the area for which the grant is given. Conditional grants prevent a municipality from establishing its own policy in areas that affect it, interfering with true long-term planning in the areas under its jurisdiction and the definition of its real priorities. Obviously, a municipality wanting to benefit from grants offered will adapt its priorities accordingly. Conditional grants encourage a negative attitude among municipalities if they begin to anticipate intervention by the two other levels of government rather than developing their own programs and doing their own planning. On another level, they can serve as an easy way out for provincial legislatures, which can delegate certain difficult services to municipalities, all the while retaining control through such grants. In this way, provincial legislatures avoid having to provide such services or being held responsible for them by the public. Furthermore, conditional grants are often given in an excessively discretionary and unilateral way. Finally, they make the decision-making process much more cumbersome.

Whether conditional or unconditional, grants seem to us to be an inadequate method of financing and an unsatisfactory solution to the financial problems of municipalities.[94] While our recommendation is that conditional grants should be substantially reduced, it is impossible to eliminate them completely because they can be necessary to guarantee certain absolutely essential standards. They can also help ensure that taxpayers in one municipality, which offers useful services to other communities, are not forced to bear the whole financial burden themselves. Conditional grants should, however, be given sparingly. The current number and very large proportion of revenues they represent to Canadian municipalities is unacceptable because they damage municipal autonomy and run counter to the purpose of municipalities.

Unconditional grants offer fewer disadvantages because they at least allow municipalities the freedom to spend the funds as they wish. However, they do not contribute to the financial responsibility of municipalities, and so should also be reduced to the minimum.

Provincial Grants

In 1982, provincial grants represented 45.9 percent of revenues for Canadian local governments, totalling $15,473.4 million. This was divided into 42.3 percent of conditional grants ($14,265.6 million) and 3.6 percent of unconditional grants ($1,207.8 million). Conditional provincial grants involved the following sectors:[95]

	Millions of $
Provincial Governments	
General government	24.3
Protection of people and property	60.0
Transport and communications	965.7
Environment	326.5
Health	1,276.9
Social service	601.5
Planning and regional development	20.5
Recreation and culture	200.8
Conservation of resources and industrial development	86.6
Education	9,980.8
Debt servicing	473.9
Other services	246.7
Total	14,264.2
Provincial Crown Corporations	1.2
Grand Total	14,265.4

The same year, provincial governments and their companies also paid grants in lieu of municipal taxes that totalled $495.8 million.[96]

Quebec, however, is a special case. The reform of municipal taxation in 1979 limited the power of school boards to levy school taxes and in this way allowed municipalities to occupy a field previously taken by the standardized school tax, which brought in about $621 million. This reform also eliminated the more important unconditional provincial grants and most of the conditional ones.[97] In 1983, grants accounted for only 2.2 percent of the income of Quebec's municipalities, or 2 percent of conditional grants ($72.9 million) and 0.2 percent for unconditional grants ($8.4 million).[98] In this area, Quebec's municipal institutions have more autonomy than those in the other provinces. Otherwise, Quebec has shown the same centralizing trend as the rest.[99]

Provincial grants should be reduced to a minimum for the reasons already stated, with conditional grant programs established only after consultation with municipalities. Furthermore, they should involve very specific goals which leave a minimum autonomy to the municipalities, enabling them to proceed without continual reference to provincial authorities.[100]

Finally, provincial legislatures should establish an equalizing scheme to compensate for the lower taxing capacity of some municipalities and to ensure a minimum income to all municipalities so that they can all provide the absolutely essential services.[101] Such a system already exists in some provinces. This scheme would result in unconditional grants and so safeguard the autonomy of municipalities.

Federal Grants

In 1982, conditional federal grants amounted to 0.9 percent of the revenues

of Canada's municipalities, totalling $134.6 million. They were allocated to the following sectors:[102]

	Millions of $
Federal Government	
General government	3.5
Protection of people and property	0.8
Transport and communications	35.0
Environment	26.9
Planning and regional development	20.0
Recreation and culture	15.5
Other services	27.3
Total	129.0
Crown Corporations	5.6
Grand Total	134.6

In 1982, the federal government and its Crown corporations also paid an amount totalling $215.6 million as grants in lieu of taxes.[103]

Since the municipalities are responsible to the provincial legislatures and it is desirable for them to remain so, the federal government should not award them unconditional grants.

For the reasons given in discussing the power to spend and the use of grants as a method of financing, conditional federal grants should be made only in areas under federal jurisdiction, and they should be the exception. Finally, they should be preceded by consultation with the provincial and municipal governments and, as in the case of conditional provincial grants, they should involve very specific projects and leave a minimum of autonomy for the municipalities. Such grants require the approval of provincial legislatures and this is quite reasonable since municipalities are under provincial jurisdiction.

Independent Sources of Revenue

The main independent source of municipal revenue is the property tax. But municipalities have other sources of funding as well and could have more.

Property Tax

Traditionally, property taxes are the prime source of revenue for municipalities in countries where there is strong local government.[104] Despite their regressive nature, which incidentally should not be exaggerated,[105] property taxes represent a real asset for municipalities, with the advantage that they are at least roughly linked to the services the taxpayers receive. Their abolition would be harmful to municipal autonomy.

An increase in the property tax rate could theoretically increase the independent revenues of the municipalities. But, in Canada, the property tax rate is already high and further significant increases would be difficult to implement.

Property tax is not used solely for municipal purposes. It is also used for education. In fact in 1982, taxes for educational purposes in Canada, mainly property taxes, amounted to $4,796.3 million.[106] Yet property has little to do with the educational services provided. If this tax were reserved for municipalities, their revenues would increase and their dependence on provincial grants decrease. In Quebec, the very severe limits placed on the power to levy property taxes for educational purposes has resulted in reducing the proportion of provincial grants awarded to other municipal revenues to 2.2 percent.[107]

Furthermore, the number of municipal tax exemptions, whether from property or other taxes, should be reduced to a minimum: while it is fair for each individual to pay for the services he receives, it is unfair for taxpayers of one city to be forced to pay all the costs for services, organizations or institutions that are also used by others. In fact, tax exemptions mean higher taxes for non-exempt taxpayers.

The federal and provincial governments should be obliged to pay all their municipal taxes or, at the very least, an equivalent amount. It should be noted here that while some provincial governments do so, the federal government, as we have seen, pays a sum equivalent to only a part of the relevant amount.[108]

The question also arises whether buildings of religious, charitable or educational institutions should be exempt from municipal taxes. Confusion seems to exist here between two distinct powers, that of assisting and subsidizing such institutions and that of imposing taxes. If the provincial legislature wishes to subsidize or authorize municipalities to subsidize such institutions, should it not do so directly, rather than forcing the municipalities to give indirect subsidies, in the form of tax exemptions, and therefore oblige taxpayers to bear the additional burden represented by these exempt institutions which benefit surrounding communities just as much as their own.

Other Taxes

Service taxes are very justifiable sources of revenue for municipalities.[109] They are closely linked to the services offered and clearly convey their cost to the people. The user pays directly for the services used. Such taxes might well be extended to other services.

Business tax represents an attractive source of revenue for municipalities. It can be justified by the additional costs which business imposes on municipalities.

Municipalities have the power to levy other taxes, depending on the province. These do not need to be discussed here.

The taxes which municipalities can now levy are inadequate for their needs. If no reform for reserving property tax for municipalities is introduced or if some such reform is made but does not succeed in filling the gap between municipal revenues and needs, other sources of revenue will have to be devised.

One solution might be to allocate a proportion of a provincial tax to municipalities. The tax on motor vehicles and fuels would be particularly appropriate in this case, in view of municipal responsibilities for roads and public transport.[110]

A municipal income tax might be considered or municipalities might receive a proportion of the provincial income tax.[111] However, such tax would present a great many problems if it were distinct from provincial taxes. The other two levels already collect income tax and the total paid by Canadians is high. Besides, the collection of such a tax by municipalities would be difficult and expensive, and could result in many opportunities for tax evasion.

But provincial legislatures could guarantee municipalities a percentage of their income tax.[112] The resulting loss of revenues would be offset by grants they would no longer be obliged to pay to the municipalities, and the latter would not have to collect the taxes themselves. Municipalities could have the choice of levying such a tax or not and could set the rate within limits set by the legislature. The advantage of this solution is that it would perfectly respect municipal autonomy and the financial responsibility of municipalities. The disadvantage would be the problems in collecting a tax that could vary from one community to another and so act as an incentive for people or businesses to move.

Another solution would be to impose a uniform rate for all municipalities. This would reduce the problem of collecting the taxes and the likelihood of moves but it would remove some of the autonomy and responsibility of municipalities, because they would lose the option of either cancelling the tax or setting its rate according to their needs.

Constitutional Protection

In his famous report of January 31, 1839, Lord Durham spoke out in favour of a system of municipal institutions. He reasoned that such institutions are necessary in an efficient parliamentary system so that the people can settle their local problems and learn to become interested and involved in central problems. Strongly criticizing the absence of municipal institutions in Lower Canada, he said:

> If the wise example of those countries in which a free representative government has alone worked well, had been in all respects followed in Lower Canada, care would have been taken that, at the same time that a Parliamentary system, based on a very extended suffrage, was introduced into the country, the people should have been entrusted with a complete control over their

> own local affairs, and been trained for taking their part in the concerns of the Province, by their experience in the management of that local business which was most interesting and most easily intelligible to them.[113]

Lord Durham felt that municipal institutions were again necessary because they provided a limit to the powers of the legislature:

> A general legislature, which manages the private business of every parish, in addition to the common business of the country, wields a power which no single body, however popular in its constitution, ought to have . . .[114]

He added that municipalities should have the power to levy taxes.

Lord Durham recommended that municipal institutions be guaranteed by the Constitution. He gave as a reason that the legislature would never agree to renounce the taxation powers necessary for the establishment of a good system of municipal institutions.[115] Current history shows him to have been substantially correct.

The first Act of Union proposed on June 20, 1839 followed the recommendation of the Durham Report and established municipal institutions in a United Canada.[116] But this draft was broadly criticized, particularly by the residents of Upper Canada, and it had to be withdrawn.[117]

A new draft of the Act of Union including a system of municipal institutions was proposed by the Governor of Canada, Charles Poulett Thomson,[118] a confident supporter of Durham's ideas, particularly on municipal institutions. Thomson wrote to the colonial secretary, Lord John Russell:

> The establishment of Municipal Govt. by Act of Parlt. is as much a part of the future scheme of Govt. for Canada as the Union of the two Legislatures, and the more important of the two.[119]

The provisions of the draft relative to municipal institutions were highly controversial and the British government decided to eliminate them in order not to impede the rest of the draft.[120] Unhappy with this decision, Thomson wrote to Russell on September 16, 1840: "It is with the deepest mortification that I find that the whole of the system for the establishment of local government has been omitted from the Bill." He added that he deeply regretted this decision and was surprised by it: "I should have been far less surprised to find the Union Bill abandoned altogether by the Government, than this most essential part of it withdrawn."[121]

There was never another attempt to guarantee municipal institutions in the Canadian Constitution.

Even though it has not been successful as yet, it is the same request for constitutional protection that the Federation of Canadian Municipalities,[122] some provincial associations of municipalities and a number of municipalities are repeating today.[123]

In our opinion, it is unrealistic to think that municipalities can be protected by the Constitution. Such an amendment to the Constitution would

alter the division of powers and would require favourable resolutions adopted by the majority of the members of the Senate, the House of Commons and the legislative assemblies of at least two-thirds of the provinces representing at least 50 percent of the population of all the provinces.[124]

It is out of the question that the legislative assemblies of such a majority of provinces would agree to this loss of power.[125] Even if such a majority were obtained, the amendment would not take effect in any province whose legislature had adopted a resolution of disagreement by the majority of its members before the Governor General's proclamation effecting such an amendment.[126]

Such an amendment is not desirable.[127] It is preferable for municipalities to continue under the provincial legislatures. Protection of municipalities by the Constitution would achieve the very opposite. It would favour direct federal intervention and direct dealings between the federal government and the municipalities. The resulting division of powers would be even more complicated and a matter of contention. Given the difficulties the federal government and our ten provinces have now in reaching agreement, it is easy to imagine what would happen if the more than 4,600 Canadian municipalities were added!

Municipal associations can assist their members in protecting their interests through exchanges of information, discussions and participation in common struggles, but they do not have the representative nature of the federal or provincial governments and they could only with difficulty play the same role as the governments if the municipalities were protected by the Constitution. The municipal councils are the organizations which are responsible to the electorate, not the associations which they join.

Furthermore, the associations cannot convey the variety of opinions which characterize municipalities, because each association necessarily represents the will of the majority of its members. Municipal associations are thus in a difficult dilemma: either they must seek the lowest common denominator and give expression to the widest spectrum of opinion, in this way losing their effectiveness, or they must make more specific demands on behalf of the majority at the expense of diversity, thereby stressing the federal or provincial, rather than the local, aspect of the association. Municipal associations even risk becoming information agencies of the federal or provincial governments rather than true representatives of their municipalities.[128]

Even in the role they play now, municipal associations should be subsidized by their own members and not by the federal or provincial government. If such an association receives subsidies, it will tend to promote the ideas of the government which provides its funding and will be reluctant to oppose it.[129]

It would be more realistic to protect municipal interests by way of provincial constitutions.[130] Perhaps it would be possible to convince a few

of the provincial legislatures in the first instance, then others and finally all of them, to grant such protection. It might mean including in the provincial constitution such fundamental principles as the existence of autonomous municipalities governing local affairs, the election of municipal councillors and the possession by municipalities of independent sources of revenue sufficient to allow them to perform their obligations. The right of a municipality to act by itself in the absence of legislation to the contrary, as well as its right to delegate its powers, could also be included in the constitution. The review of municipal by-laws by courts could be limited.

The guarantees given in this way might not be revoked or amended except by statute passed by the absolute, or even a greater, majority of the members of a legislative assembly. Such guarantees would have the advantage of protecting municipalities, clarifying their status, giving them greater security and greater room for manoeuvre, making them more than just tools of the provincial legislatures whose autonomy can be diminished or completely revoked by an ordinary provincial law.

Creation of New Provinces

Large cities are of special importance and have special problems. There are 25 Canadian cities with larger populations than the country's smallest province. There have already been proposals to increase the number of provinces to 20 or 30, to turn the main urban centres and the economic regions around them into actual provinces.[131]

Such a recommendation is not practical, however, because it would require an amendment to the Constitution authorized by resolutions of the Senate, the House of Commons and the legislatures of at least two-thirds of the provinces representing at least 50 percent of the population of all the provinces.[132] This kind of consent would just not be obtainable from the provinces.

Furthermore, a solution on these lines is not desirable because increasing the number of provinces would cost them some of their significance and promote centralism. Furthermore, the large cities are an essential part of the present provinces, and it would be no more than a contrivance to remove them. It would be hard to imagine Quebec without the Montreal region, for example. Such an amputation would be disastrous.

Tripartite Meetings

There have been two national tripartite conferences bringing together the federal, provincial, and municipal governments of Canada. The first was held in Toronto in 1972 and the second in Edmonton in 1973. A third, planned for the end of 1976, had to be cancelled in the summer of that year when the provincial governments refused to take part. None has been called since.[133]

While provincial governments have always been very reluctant to attend such meetings, it is also true that the 1972 and 1973 conferences had few practical results. However, regional and local tripartite meetings held on specific subjects, like transportation, finance and housing have been more successful.[134] In fact, municipalities, particularly the large ones, have also had informal contacts with federal authorities.

Tripartite dealings among federal, provincial and municipal authorities have no purpose when they involve only areas of provincial competence. Dealings should be bipartite, i.e., between provincial and municipal authorities only.

On the other hand, dealings among the federal, provincial and municipal authorities are necessary in areas where the exercise of federal powers affects municipal affairs. The last word with respect to dealings between municipalities and federal officials should belong to provincial authorities, which are ultimately responsible.

It does not seem to us to be a good idea to hold formal national tripartite meetings.[135] Such meetings would inevitably go beyond areas of federal competence and so give the federal authorities leadership in municipal affairs. However, tripartite provincial, regional or local meetings on specific subjects of federal jurisdiction would be useful. The presence of municipalities at such meetings would allow them not only to learn and better understand the points of view of the other levels of government, but also to express their own. Their presence would also encourage federal and provincial authorities to hold serious discussions.

Inevitably, the three levels of government will have to meet informally, from time to time, because such meetings are necessary and profitable.[136]

Municipal associations can assist municipalities, especially the less powerful ones, in their negotiations, even if they cannot represent them exclusively. Each municipality must act on its own to protect its own interests. The large cities, in particular, benefit a great deal from negotiating individually, because of their strength.[137]

Let us hope that one day, the federal and provincial authorities will understand the need for positive discussions in a spirit of positive negotiation, rather than one of rivalry and confrontation, the need to respect individual powers rather than seeking to impose their will on the other party, even in areas which are under their jurisdiction!

Conclusion

Our population today is increasingly well educated. We have extraordinary technologies that are always improving so that we can afford a level of sharing and diversity that would not have been thought of when our current institutions were put in place and the centralizing tendency began. It seems reasonable to ask whether tomorrow's world will not be the world of decentralization, as the futurologists are predicting. "It is the time of

decentralization and decomposition — what I call 'demassification'," said Alvin Toffler.[138]

Canadian politicians still incline toward the centralizing idea, but for how much longer? The outlook of Canadians has begun to change. As the Federation of Canadian Municipalities has remarked:

> So entrenched did the direction of change [toward centralization] appear to numerous commentators in the 60s, that many predicted what might be called "a withering away" of local government. . . . Clearly, however, this has not happened. On the contrary, starting in the late 60s and early 70s, struggles over environmental quality and a host of community planning and other quality-of-life issues have found their main outlet at the local level since it is here that the majority of these are regulated.
>
> . . . Today people once again value towns and cities sufficiently to commit themselves to making them better places in which to work, live and play.[139]

It adds:

> We seem, in effect, to be coming full circle: from a time when locally-based institutions bore responsibility for all aspects of daily life, to one in which the capacity to fulfill this role has been eroded and therefore largely removed to other orders of government, to one in which people are again viewing local government and institutions as the most direct and accessible outlet for their most pressing concerns.[140]

Other countries are on the road to decentralization. Even in France, the supreme example of the unitary state, a decentralizing reform has been enacted. Though this reform is still tentative and French municipalities are far from possessing the same significance as Canadian or American municipalities, its very existence speaks volumes.

Far from seeing their role diminish in a decentralized world, the municipalities will see their importance and autonomy increase. "As the optimum unit for democracy in the 21st century, the city has a greater claim, I think, than any other alternative," said Professor Robert A. Dahl.[141] In a world which will be at one and the same time more internationalized and more decentralized, it seems reasonable to ask whether economic nationalism and the state as we know it will not be the institutions that are called upon to give way.

Notes

This study is a translation of the original French-language text which was completed in July 1984.

1. *Édits et ordonnances*, vol. 2 (Québec: Fréchette, 1955), p. 6; *Jugements et délibérations du Conseil souverain de la Nouvelle-France*, vol. 1 (Québec: Côté, 1885), p. 5.
2. *Édits*, *supra*, n. 1, p. 13; *Jugements*, *supra*, n. 1, 57; L'Heureux, (1981), par. 6, p. 5.
3. L'Heureux, *supra*, n. 2, par. 7, p. 5.
4. 33 Geo. III, c. 2 (H.C.), July 9, 1793; Rogers (1971), par. 8.2, pp. 30–32.

5. An Ordinance to prescribe and regulate the election and appointment of certain officers, in the several Parishes and Townships in this Province, and to make other provisions for the local interests of the Inhabitants of these Divisions of the Province, 1840, 4 Vict., c. 3; An Ordinance to provide for the better internal Government of this Province, by the establishment of local or municipal authorities therein, 1840, 4 Vict. c. 4.
6. 1 Will. IV, c. 52, s. 54.
7. Cameron, (1980a), pp. 222–35; Dahl (1981), pp. 33–60; Dupré (1968); Dupré (1972), pp. 284–89; Frug (1980), pp. 1059–1154; Higgins (1977), pp. 45–92; Johnson (1980), pp. 146–69; Maass (1959); Magnusson (1981), pp. 61–86; Plunkett and Graham (1982), pp. 603–18; Sharpe (1981), pp. 28–39; Wharren (1950), pp. 11–16; Wickwar (1970).
8. Gramlich and Rubinfeld (1982), pp. 526–60; Tiebout (1956), pp. 416–24.
9. Feldman and Graham, (1979), pp. 97–123.
10. Langrod (1981), pp. 3–14; Moulin (1981), pp. 19–24.
11. Panter-Brick (1981a), pp. 14–19; Panter-Brick (1981b), pp. 24–27; Whalen (1972), pp. 358–79.
12. Johnson, *supra*, n. 7.
13. Moulin, *supra*, n. 10.
14. Cameron, (1980b), p. 195 at p. 197.
15. Head 2.
16. Head 9.
17. Head 13.
18. Head 16.
19. *Hodge v. The Queen* (1883), 9 App. Ces. 117; *A.-G. Ont. v. A.-G. Can., Re Prohibitory Liquor Laws Case*, [1896] A.C. 348; *Ladore v. Bennet*, [1939] A.C. 368, 3 D.L.R. 1, affirming [1938] O.R. 327, 3 D.L.R. 212 (C.A.); Gibson (1980), at p. 1; Hogg (1977), pp. 44–45; L'Heureux, *supra*, n. 2, paras. 29–35, pp. 17–24; Rogers, *supra*, n. 4, par. 63.13, pp. 316–36; Tremblay and Savoie (1973), pp. 23–39; Tremblay and Turp (1981–82), at p. 284. The federal Parliament has, however, authority over municipalities on territories outside the provinces: *Dinner v. Humberstone* (1896), 26 S.C.R. 252.
20. *Hodge v. The Queen*, *supra*, n. 19; *A.-G. Ont. v. A.-G. Can., Re Prohibitory Liquor Laws Case*, *supra*, n. 19; *Clarke v. Wawken*, [1930] 2 D.L.R. 596; *Commission municipale du Québec v. Ville d'Aylmer* (1933), 71 Que. S.C. 117; *Shannon v. Lower Mainland Dairy Products Board*, [1938] A.C. 708, 2 W.W.R. 604, 4 D.L.R. 81; *Ladore v. Bennett*, *supra*, n. 19; Hogg, *supra*, n. 19, pp. 214–15 ; Laskin (1975), pp. 595–600; L'Heureux, *supra*. n. 2, par. 32, pp. 20–21; Rogers, *supra*, n. 4, par. 63.13, p. 318; Tremblay and Savoie, *supra*, n. 19, pp. 30–31.
21. (1883), 9 App. Cas. 117, at p. 132.
22. [1959] O.R. 26, 16 D.L.R. 624 (C.A.).
23. Gibson, *supra*, n. 19, p. 12.
24. Ibid.
25. [1960] S.C.R. 307.
26. Bolduc (1980), pp. 60–75; Dupré (1972), *supra*, n. 7; Feldman and Graham, *supra*, n. 9, pp. 5–12; Higgins, *supra*, n. 7; L'Heureux, *supra*, n. 2; L'Heureux (1984); Makuch (1983); Plunkett and Betts (1978); Plunkett and Graham, *supra*, n. 7; Rogers, *supra*, n. 4. See Makuch (1985) on the development of urban law in Canada since 1945.
27. Makuch, *supra*, n. 26, pp. 26–28.
28. It is not possible in this paper to deal further with the question of regional municipalities since we are dealing here with the subject of municipalities and power sharing and not with their internal structure. Another study (see n. 26) covers the subject of urban law after 1945.
29. [1896] A.C. 348; Gibson, *supra*, n. 19, pp. 1–3; L'Heureux, *supra*, n. 2, par. 32.1, pp. 21–22; Rogers, *supra*, n. 4, paras. 63.12, 63.13, pp. 311, 317; Tremblay and Turp, *supra*, n. 19. p. 286.

30. *Re Slavin and Village of Orillia* (1879), 35 U.C.Q.B. 159; *Re Harris and City of Hamilton* (1879), 44 U.C.Q.B. 641; *Sulte v. The Corporation of The City of Trois-Rivières* (1883–86), 11 S.C.R. 25; *Re Huson and Township of South Norwich* (1895), 24 S.C.R. 145.
31. *Henry Birks & Sons (Montreal) Ltd. v. City of Montreal*,[1955], S.C.R. 799, 5 D.L.R. 321, reversing [1954] Que. Q.B. 679; *Hlookoff v. City of Vancouver* (1968), 63 W.W.R. 129, 69 D.L.R. 119 (B.C.S.C.); See Chevrette (1969), p. 17.
32. *Johannesson v. Rural Municipality of West St. Paul*, [1952] 1 S.C.R. 292, [1951] 4 D.L.R. 609, reversing [1950] 1 W.W.R. 856, 3 D.L.R. 101 (Man. C.A.), aff'd [1949] 2 W.W.R. 1, 3 D.L.R. 694 (Man. K.B.).
33. *Saint-Léonard v. Fournier* (1956), 115 C.C.C. 366 (N.-B. C.A.); *Poole v. Tomlinson* (1957), 118 C.C.C. 384 (Sask. C.A.); *District of Kent v. Storgoff* (1962), 38 D.L.R. 362 (B.C.S.C.); *Hurrel v. City of Montreal*, [1963] R.P. 89 (C.S.); *A.-G. Can. v. Ville de Montréal*, [1978] 2 S.C.R. 770, affirming [1974] C.A. 402.
34. Gibson, *supra*, n. 19, pp. 15–16; Rogers, *supra*, n. 4, par. 63.12, pp. 313–16.
35. *Johannesson v. Rural Municipality of West St. Paul*, *supra*, n. 32; *Montreal Flying Club v. City of Montreal North*, [1972] C.S. 695; *Re Orangeville Airport and Town of Caledon* (1975), 11 O.R. 546, (1976) 66 D.L.R. 610 (C.A.).
36. *Toronto v. Bell Telephone*, [1905] A.C. 52.
37. *Public Service Board (Quebec) v. Dionne*, [1978] 2 S.C.R. 191.
38. *C.P.R. v. Notre-Dame de Bonsecours*, [1899] A.C. 367; *Cardinal v. A.-G. of Alberta* [1974] S.C.R. 695; *Hamilton Harbour Commission v. City of Hamilton* (1978), 21 O.R. 459, 6 M.P.L.R. 183, 91 D.L.R. 353 (C.A.), affirming (1976) 1 M.P.L.R. 133 (H.C.).
39. *C.P.R. v. Notre-Dame de Bonsecours*, *supra*, n. 38.
40. *Hamilton Harbour Commission v. City of Hamilton*, *supra*, n. 38.
41. Tremblay and Turp, *supra*, n. 19, p. 289.
42. *Johannesson v. Rural Municipality of West St. Paul*, *supra*, n. 32; *Montreal Flying Club v. City of Montreal North*, *supra*, n. 35; *Re Orangeville Airport and Town of Caledon*, *supra*, n. 35.
43. See, especially, Lajoie (1968), pp. 57–58. *Groupe de travail sur l'urbanisation au Québec* (1976), pp. 135, 327–38. Scott and Lederman (1972), p. 43; Tremblay and Turp, *supra*, n. 19, pp. 296–304.
44. See Canada, Ministry of State for Urban Affairs (1973), p. v.
45. *Constitution Act, 1982*, subsecs. 38(1), (2); Resource Task Force on Constitutional Reform (1982), pp. 6–8.
46. As to the position of the provinces, see Task Force on Constitutional Reform (1980), pp. 19–59; Resource Task Force, *supra*, n. 45, pp. 2–24.
47. *Constitution Act, 1982*, subsec. 38(3); Resource Task Force, *supra*, n. 45, pp. 7–8.
48. See Cameron (1974), pp. 228–52; Feldman and Graham, *supra*, n. 9, pp. 29–58.
49. *Constitution Act, 1867*, s. 91, head 1*a*.
50. *R. v. Red Line* (1930), 66 D.L.R. 53, 54 C.C.C. 271 (App. Div.); *Spooner Oils v. Turner Valley Gas Conservation Board*, [1933] S.C.R. 629, 4 D.L.R. 545; *Deeks McBride v. Vancouver Associated Contractors*, [1954] 4 D.L.R. 844 (B.C.C.A.); *City of Ottawa v. Shore and Horwitz Construction* (1960), 22 D.L.R. 247 (Ont. H.C.); Brossard et al. (1970), pp. 210–11; Laforest (1969) pp. 134–36, 190–95; Laskin, *supra*, no. 20, pp. 524–30; Tremblay and Turp, *supra*, n. 19, p. 288.
51. *National Capital Act*, R.S.C. 1970, c. N-3; *Munro v. National Capital Commission*, [1966] S.C.R. 663, affirming [1965] 2 Ex C.R. 579.
52. As to the authority of the federal Parliament on questions of expropriation, see Laforest, *supra*, n. 50; Lajoie (1972).
53. *National Parks Act*, R.S.C. 1970, c. N-13.
54. *Constitution Act, 1867*, s. 125; *Calgary and Edmonton Land v. Attorney-General of Alberta* (1912), 45 S.C.R. 170; *Société centrale d'hypothèques et de logement v. Cité de Québec*, [1961] Que. Q.B. 661; *City of Quebec v. The Queen*, [1961] Ex. C.R. 55;

Commission scolaire de Chomedey de Laval v. Société d'habitation du Québec, [1981] Que. C.A. 27. Certain grants are made to municipalities under the *Municipal Grants Act, 1980* (S.C. 1980, c. 37), in part compensation for the exemption.

55. *Attorney General of Canada v. City of Toronto* (1892–94), 23 S.C.R. 514; *Minister of Justice of Canada v. City of Lévis*, [1919] A.C. 505, 45 D.L.R. 180.
56. *Constitution Act, 1867*, ss. 91, head 29 and 92, head 10c; Gibson, (1971); Lajoie (1969).
57. Gibson, *supra*, n. 56; Lajoie, *supra*, n. 56.
58. See Driedger (1981); Hanssen (1967); Laforest (1967), pp. 36 *et seq.*; Scott (1955–56); Smiley (1963). This power would flow from the Constitution Act, 1867 s. 91, heads 1A and 3 and s. 102, as well as from s. 36 of the *Constitution Act, 1982*. Equalization payments are authorized by the *Constitution Act, 1982*, s. 36.
59. *Central Mortgage and Housing v. Cooperative College Residences* (1975), 71 D.L.R. 183, (1977) 13 O.R. 394 (C.A.).
60. *Department of Regional Economic Expansion Act*, R.S.C. 1970, c. R-4. This department has been superseded by the Department of Regional Industrial Expansion (S.C. 1980–81–82–83, c. 167).
61. *Central Mortgage and Housing Corporation Act*, R.S.C. 1970, c. C-16; *National Housing Act*, R.S.C. 1970, c. N-10. As to the authority on matters of housing, see L'Écuyer (1975); Scott and W. Lederman, *supra*, n. 43.
62. Central Mortgage and Housing Corporation, *Annual Report*, Ottawa, C.M.H.C., 1982, p. 38.
63. L'Heureux, *supra*, n. 2, par. 30, pp. 17–20. Tremblay and Turp, *supra*, n. 19, p. 319. For a favourable view on federal action in urban questions, see Lithwick (1970); Canada, Ministry of State for Urban Affairs (1972).
64. *Rapport Castonguay*, *supra*, n. 43, p. 337.
65. See Beaudoin (1983), pp. 341–49; Dupont (1967), p. 69; Magnet (1978), pp. 480–81; Trudeau (1967), p. 145; Trudeau (1969).
66. [1937] A.C. 355, 1 D.L.R. 684.
67. *St. Catherine's Milling and Lumber v. The Queen* (1887), 13 S.C.R. 577; *C.P.R. v. Notre-Dame de Bonsecours*, [1889] A.C. 307; *Rex v. Zaslavsky*, [1935] 2 W.W.R. 34, 3 D.L.R. 788 (Sask. C.A.); *A.-G.N.S. v. A.-G. Can., Nova Scotia Interdelegation Case*, [1951] S.C.R. 31, [1950] 4 D.L.R. 369; Beaudoin, *supra*, n. 65, p. 473; Driedger (1976), p. 695; Fairweather (1970), p. 43; Gibson, *supra*, n. 19, pp. 12–13; Hogg, *supra*, n. 19, pp. 223–25; LaForest (1979), p. 131; Laskin, *supra*, n. 20, pp. 2–10; Lederman (1967), at p. 409; Lysyk (1969), p. 271. Professor Pierre Blache considers, contrary to the majority view, that *A.-G.N.S. v. A.-G. Can., Nova Scotia Interdelegation Case* impedes only delegation of a basic legislative power: See Blache (1976).
68. It can be argued to the contrary that delegation is not an abdication of power: Ballem (1952), p. 79; Hogg, *supra*, n. 19, pp. 223–26; Fairweather, *supra*, n. 67; Scott (1948), p. 984; Shannon (1928) p. 245; Tuck (1945), p. 79; Wahn (1936), p. 353.
69. *P.E.I. Potato Marketing Board v. H.B. Willis*, [1952] 2 S.C.R. 392, 4 D.L.R. 146, rev'd [1952] 4 D.L.R. 146 (P.E.I.S.C.); *Coughlin v. Ontario Highway Transport Board*, [1968] S.C.R. 569, 68 D.L.R. 384, aff'd [1966] 1 O.R. 183, 53 D.L.R. 30 (C.A.); *R. v. Smith*, [1972] S.C.R. 359, 21 D.L.R. 222, rev'd [1971] 3 C.C.C. 162, 17 D.L.R. 590 (Alta. App. Div.); *Reference re Agricultural Marketing Act et al.*, [1978] 2 S.C.R. 1198, reversing (in part) (1977), 16 O.R. 451 (C.A.); Ballem (1952), p. 1050; Beaudoin, *supra*, n. 65, pp. 473–74; Blache, *supra*, n. 67; Driedger, *supra*, n. 67; Fairweather, *supra*, n. 67; Hogg, *supra*, n. 19; Laskin, *supra*, n. 20; Lysyk, *supra*, n. 67. This series of judgments of the Supreme Court of Canada is unexpected, since it seemed to flow logically from the prohibition of delegation between the federal Parliament and the provincial legislatures, the prohibition of delegation between the federal Parliament and a subordinate body of a provincial legislature: Ballem, *supra*, Blache, *supra*, n. 67; Fairweather, *supra*, n. 67; Lysyk, *supra*, n. 67. Professor Driedger is of the opinion, however, that there is no contradiction because a commission, a public enterprise, an office or a provincial corporation is not an agent of a provincial legislature even if it may be an agent of the provincial executive: *supra*, n. 67, pp. 696–703.

70. Driedger, *supra*, n. 67, pp. 700–701; Gibson, *supra*, n. 19, p. 13; L'Heureux, *supra*, n. 2, par. 35, p. 24; Tremblay and Turp, *supra*, n. 19, p. 286. *Contra*: Rogers, *supra*, n. 4, par. 63.12, p. 312.
71. *Grand Trunk v. City of Toronto* (1900), 32 O.R. 120 (H.C.). On the other hand, it must be emphasized that in the case of *Re Prohibitory Liquor Laws*, Sedgwick, J. states that the federal Parliament may delegate its relevant federal powers to municipalities: (1895), 24 R.C.S. 170, p. 247, rev'd (in a judgment not giving rise to this discussion) by [1896] A.C. 348.
72. *Grand Trunk v. City of Toronto*, *supra*, n. 71; Gibson, *supra*, n. 19, pp. 13–14; L'Écuyer, *supra*, n. 61, pp. 237, 271, 285, 297–304; L'Heureux, *supra*, n. 2, par. 35, p. 29; Rogers, *supra*, n. 4, par. 63.12, p. 312; Scott and Lederman, *supra*, n. 43, p. 43; Tremblay and Turp, *supra*, n. 19, p. 286.
73. L'Écuyer, *supra* n. 61, pp. 237, 271; Scott and Lederman, *supra*, n. 43, p. 43; Tremblay and Turp, *supra*, n. 19, p. 286.
74. (1971), 105 *Can. Gaz.* II, 1113.
75. (1979), 113 *Can. Gaz.*, II, 1953; Feldman and Milch (1981), pp. 202–18; Feldman and Graham, *supra,* n. 9, pp. 49–52.
76. Federation of Canadian Municipalities (November 1983); Federation of Canadian Municipalities (May 1983). *Contra*: Manitoba Association of Urban Municipalities, *Brief to the Royal Commission on the Economic Union and Development Prospects for Canada*, October 1983.
77. Federation of Canadian Municipalities, *Submission*, *supra*, n. 76.
78. *Brandon v. Municipal Commissioner for Manitoba*, [1931] 3 W.W.R. 65, 3 D.L.R. 397 (Man. K.B.), aff'd [1931] 3 W.W.R. 225, 4 D.L.R. 830 (Man. C.A.); Gibson, *supra*, n. 19, p. 9; L'Heureux, *supra*, n. 2, paras. 29–30, pp. 17–18; Rogers, *supra*, n. 4, par. 63.13, pp. 316–36.
79. [1931] 3 D.L.R. 397, at p. 402.
80. *Journal Printing v. McVeity* (1915), 33 O.L.R. 166 (C.A.); *Village de Saint-Jérôme v. The Lake St. John Light and Power* (1928), 45 Que. K.B. 20; *Phaneuf v. Village de St-Hugues* (1936), 61 Que. K.B. 83; *Trudeau v. Devost*, [1942] S.C.R. 257; *Cité de Verdun v. Sun Oil*, [1952] 1 S.C.R. 222, affirming [1951] Que. K.B. 320; *Cité d'Outremont v. Protestant School Trustees*, [1952] 2 S.C.R. 506, affirming [1951] Que. K.B. 676; Driedger (1960), p. 21; Gibson, *supra*, n. 19, pp. 9–10; L'Heureux, *supra*, n. 2, par. 36, p. 24; L'Heureux, vol. 2, *supra*, n. 26, par. 599, pp. 309–10; Rogers, *supra*, n. 4, paras. 63.31–63.34, pp. 350–57.
81. *Winnipeg Electric Railway v. City of Winnipeg*, [1912] A.C. 335, 4 D.L.R. 116; *Bridge v. The Queen*, [1953] 1 S.C.R. 8, 1 D.L.R. 305; *Vic Restaurant v. Cité de Montréal*, [1957] Que. Q.B.; rev'd [1959] R.C.S. 58; L'Heureux, vol. 2, *supra*, n. 26, paras. 600–602, pp. 310–14; Rogers, *supra*, n. 4, par. 63.5, pp. 369–75; Tremblay and Savoie, *supra*, n. 19, pp. 33–38.
82. Gibson, *supra*, n. 19, pp. 10–11; L'Heureux, vol. 2, *supra*, n. 26, paras. 610–614, pp. 321–27; Rogers, *supra*, n. 4, paras. 193.1–193.2, 193.5, pp. 1010–16, 1020–23. It must be noted that right to equality is now part of the Constitution. S. 15 of the *Constitution Act, 1982* effectively recognizes this right and prohibits discrimination. S. 15 came into force on April 17, 1985 (*Constitution Act 1982*, subsec. 32(2)). But the federal Parliament or a provincial legislature may pass legislation expressly excepting its application (s. 33).
83. L'Heureux, vol. 2, *supra*, n. 26, paras. 608–609, pp. 318–21; Rogers, *supra*, n. 4, vol. 2, par. 193.4, pp. 1018–20.
84. Gibson, *supra*, n. 19, p. 11.
85. Federation of Canadian Municipalities, *supra*, n. 76.
86. Lund (1979); Union des municipalités du Québec, October 1983, pp. 15–22.
87. Federation of Canadian Municipalities, *supra*, n. 76. These figures do not include seasonal employees, employees of municipal enterprises or employees of school boards.
88. See, *supra*, n. 26.

89. Federation of Canadian Municipalities, *supra*, n. 76.
90. Canadian Tax Foundation (1983), pp. 97, 197 (estimates).
91. Ibid., p. 97 (estimates)
92. The total includes property taxes for educational purposes. Taxes for educational purposes, principally property taxes, amounted to $4,796.3 million in 1982: Canadian Tax Foundation, *supra*, n. 90, p. 259 (estimate).
93. With the exception of Quebec municipalities.
94. Bolduc, *supra*, n. 26; Divay (1980), pp. 236–51; Dupré, *supra*, n. 7; Federation of Canadian Municipalities, *supra*, n. 76; Plunkett and Graham, *supra*, n. 7; Sharpe, *supra*, n. 7, pp. 38–39; Bossons et al. (1981); Union des municipalités du Québec, *supra*, n. 86.
95. Canadian Tax Foundation, *supra*, n. 90, pp. 97, 197 (estimates).
96. Ibid.
97. *An Act Respecting Municipal Taxation*, S.Q. 1979, c. 72. This Act is now c. F-2.1 of the Revised Statutes of Quebec. As to this reform, see especially L'Heureux, vol. 2, *supra*, n. 26, paras. 683 *et seq.*, p. 361 *et seq.*; Lortie (1982), p. 117; Poirier and Lavoie, (1982), p. 141; Vaillancourt (1980), p. 274. This reform has further diminished the already declining power of local school authorities. From now on, school commissioners and regional boards can levy land taxes only "for the payment of expenses not otherwise provided for by Government subsidies or grants and other revenue": *Education Act*, R.S.Q., c.I-14, ss. 226, 441. Furthermore, a referendum is required for the imposition of tax where the total amount of expenses for the payment of which an assessment must be levied exceeds six percent of the net expense of the school board or the regional board, or the taxation rate for that assessment exceeds 25 cents per 100 of the standardized assessment of the taxable property included in the real estate base of the school board or regional board: R.S.Q., c.I-14, ss. 354.1–354.3. On the constitutionality of this reform concerning s. 93 of the *Constitution Act, 1867,* see *A.G. Quebec v. Hull School Board*. J.E. 85-41. S.C. Can. (This judgment was handed down in December 1984, five months after the completion date of this study.)
98. Quebec Bureau of Statistics, *Analyse budgétaire des municipalités du Québec* (Quebec: 1983). The statistics cover only municipalities with 5,000 or more inhabitants; they do not apply to local school boards.
99. As to urban planning, see, especially: L'Heureux, vol. 2, n. 26, par. 1476, pp. 754–57.
100. Divay, *supra*, n. 94, pp. 236–51.
101. Richmond (1980), pp. 252–80.
102. *Canadian Tax Foundation*, *supra*, n. 90, p. 97 (estimates).
103. Ibid.
104. Bélanger (1976); Bird and Slack (1983); Boadway and Kitchen (1980); Netzer (1966), pp. 11–13; Thirsk (1982), pp. 384–407.
105. Bird and Slack (1978).
106. See n. 92.
107. See n. 98.
108. See n. 54. The Union des municipalités du Québec has calculated that there is a shortfall of about $45 million just in the province of Quebec: Union des municipalités du Québec, *supra*, n. 86, p. 32.
109. Bird (1976).
110. Federation of Canadian Municipalities, *supra*, n. 76, p. 29; *Rapport Castonguay*, *supra*, n. 43, pp. 280–82.
111. Angers (1977), p. 380; *Rapport Castonguay*, *supra*, n. 43, pp. 280–82; Silver (1973), pp. 375–85; Silver (1968), pp. 398–406. See also: City of Windsor (1983); Federation of Canadian Municipalities (1983), *supra*, n. 76; Newfoundland and Labrador Federation of Municipalities (1983).
112. In Manitoba, percentages of individual and corporation income tax are allocated to municipalities: *The Unconditional Grant Act*, R.S.M. 1970, c. U-10; Canadian Tax Foundation, *supra*, n. 90, p. 126; Siegal (1980), p. 311.

113. *See Durham, 1839, p. 113.*

114. Ibid., p. 287.

115. Ibid., pp. 190, 287.

116. Bill for Reuniting the Provinces of Upper Canada and Lower Canada and for the Government of the United Provinces, June 20, 1839.

117. L'Heureux (1979), p. 339.

118. In 1840, he became Lord Sydenham.

119. See Sydenham (1840), p. 75.

120. L'Heureux, *supra*, n. 117, pp. 339–40.

121. See Sydenham (1840), p. 445.

122. Task Force, *supra*, n. 46; Resource Task Force, *supra*, n. 45. This recommendation is not dealt with expressly in the Federation of Canadian Municipalities' paper to the Royal Commission on the Economic Union and Development Prospects for Canada: *supra*, n. 76.

123. City of Windsor, *supra*, n. 111; District of Mackenzie (April 1983); Manitoba Association of Urban Municipalities, *supra*, n. 76; Newfoundland and Labrador Federation of Municipalities, *supra*, n. 111.

124. *Constitution Act, 1982*, subsecs. 38(1), (2); Resource Task Force, *supra*, n. 45.

125. As to the provincial position, see n. 46.

126. *Constitution Act, 1982*, subsec. 38(2); Resource Task Force, *supra*, n. 45, pp. 7–8.

127. Cameron, *supra*, n. 7.

128. Feldman and Graham, *supra*, n. 9, pp. 15–27.

129. Ibid.

130. As to this opinion, see Cameron, *supra*, n. 7. A recommendation in a similar sense has also been made by the constitutional committee of the Liberal Party of Quebec and, as an alternative solution, in the second report of the Task Force of the Federation of Canadian Municipalities: Task Force, *supra*, n. 46, pp. 43–45; Resource Task Force, *supra*, n. 45, pp. 8, 25–27; Constitutional Committee of the Liberal Party of Quebec (Quebec, 1980).

131. City of Ottawa (1983), pp. 11–13.

132. *Constitution Act, 1982*, para. 42(1)(f).

133. Feldman and Graham, *supra*, n. 9, pp. 29–58.

134. Ibid.

135. Ibid.

136. Ibid., pp. 125–43.

137. Ibid., pp. 15–27, 125–43.

138. *Le Nouvel Observateur*, n° 994, November 25, 1983, p. 44.

139. Federation of Canadian Municipalities, *supra*, n. 76, p. 17.

140. Ibid., p. 18.

141. Dahl, *supra*, n. 7, p. 418.

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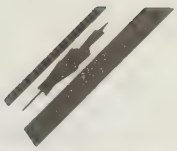

Local Government and Canadian Federalism

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Introduction

Canadian local governments are widely regarded as the minor players in the Canadian federal scene. The limelight of intergovernmental relations is taken by the federal and provincial governments, and local governments, if acknowledged, are well back in the shadows, forgotten in the excitement and turmoil of federal-provincial relations. While often unappreciated, local governments play an important role as the third tier which completes the Canadian federation in a functional sense. Just as provincial governments allow variations to accommodate regional interests and public service requirements, local governments at the subprovincial level supply significant services and provide the opportunities to structure these functions to local conditions and preferences. With the objective of providing a more comprehensive perspective of Canadian federalism, this paper examines the role of local government in our federal system. It is an effort to identify the strengths and weaknesses in the hopes that improved intergovernmental relations may evolve at the local level.

The paper begins with a conceptual examination of the role of local government. With that theoretical framework, we then focus on local government in Canada. We begin with a brief note on constitutional status and follow with a discussion of developments leading to the current role of local government. The major issues involving local government in its present situation are identified. How local government will fare in the future if it continues to operate under the existing arrangements is also a topic upon which we reflect. Finally, we assess a variety of alternative arrangements. Our conclusion completes the paper.

A Conceptual View of the Role of Local Government

Before proceeding to a description and assessment of Canadian local governments, it is essential to outline the role which local governments ought to play.[1] The two primary functions of local government are often described as being access and service.[2] Access refers to the provision of goods and services in a fashion which is both efficient and conforms to local tastes. While acknowledging the importance of access, we focus here on service. Drawing upon the theory of fiscal federalism as it applies to local units, we discuss the allocation of functional and financial responsibility and the determinants of public sector performance.

Service Responsibility

In a federal system such as exists in Canada, local governments have the capacity to provide some services more effectively than either the federal or provincial governments. This situation arises when the provision of services are local, in the sense that they affect a relatively small and geographically connected subgroup of the country or province or for which local conditions and/or local preferences differ significantly among localities. These circumstances argue for local decision making and at least an economic form of federalism.[3]

Within a federalist system, determination of the appropriate level of government to provide public services becomes an important issue. Breton (1965) advances the concept of the "perfect mapping" under which each jurisdiction exactly encompasses those affected by its policies and provides an efficient amount of public good as determined by costs and residents' preferences. At the limit, this approach implies one government for each public good and so implies a costly and likely very confusing public sector. In the face of such realities, Breton and Scott (1978, 1980) propose that a federation be designed so as to minimize organization costs, as, for example, those of signalling preferences (including interjurisdictional migration), intergovernmental coordination, and administration. A constituent assembly would, presumably, seek to minimize such costs in designing a federal system so as to achieve an effective compromise among the economies of scale.

Economies of scale refer to the ability to reduce costs per unit of output as output increases. Where available, they imply that governments, or their service areas, should be large enough to achieve the full-cost economies in providing the service. Though often not distinguished from economies of scale, cost savings can accrue to citizens as a result of more people sharing a given facility. Greater numbers, however, make it possible that congestion will reduce service quality. Overall, economies in public service provision require that each service be provided by the level of government able to supply it at least cost.[4]

If a significant portion of the benefits from goods and services provided by one government spill beyond its jurisdiction to benefit residents of other communities without corresponding compensation, those services will tend to be undersupplied. Alternatively, if costs spill over to other jurisdictions, owing, for example, to the ability to shift local taxes to non-residents or because non-residents share (or bear all) the inconveniences, the local service will tend to be oversupplied. The problem may be resolved by expanding the size of the jurisdiction or by turning responsibility for the delivery and financing of such services over to a broader authority such as a metropolitan or regional government or to the province. Such moves would ensure that most of the beneficiaries were under the jurisdiction of the producing authority and that their preferences were better represented.[5] Alternatively, a broader authority could provide grants (or charge taxes) to compensate localities for the benefits (costs) which spill beyond their borders. A conditional matching grant specific to the spillover is an appropriate mechanism for solving this problem.[6] Regulation by a broader authority designed to reflect the interests of those outside the jurisdiction is an alternative approach. However, because it introduces legal requirements or obstacles rather than positive incentives for more socially desirable action, regulation may be less successful than economic inducements. Yet, effective economic incentives may sometimes be almost as difficult to design as good regulation.

Low political decision-making costs are also an objective. Because public services are shared or consumed jointly, a democratic decision can be made on the services to be provided and the distribution of their costs. Arriving at these decisions is not always simple or easy and the political process involves costs of time, effort and resources. Generally speaking, it is expected that agreement is more readily achieved among smaller groups. But while smaller groups may reduce internal decision-making costs, they may necessitate greater external or intergroup costs if externalities remain.

In establishing a suitable role for local government, constitutional decision makers pursuing minimum organization costs need to define a blend which successfully accommodates concern for the efficient provision of public services, minimization of benefit and cost spillovers, and low political decision-making costs. Consideration of these factors is helpful when assuming the role which local government might play in satisfying the three major areas of government functional responsibility — the stabilization of economic activity, the distribution (or redistribution) of income, and the provision of public goods and services. Because of the limited effects and the large spillovers which would occur if local government attempted to stabilize the economy or influence income distribution, these functions are best performed by the national and provincial governments. The failure of the senior governments to assume these functions can have serious consequences for local government and impede the performance of the federal system. For example, Oakland (1979) attributes much of

the fiscal problem encountered by central cities in the United States to excessive responsibility for (or at least the undertaking, and hence funding, of) redistributional services. National and provincial governments must also provide for public goods or share the responsibility for the provision of public goods involving spillovers — interprovincial spillovers in the case of the federal government and interlocal spillovers in the provincial case. Local government is best suited to performing allocative functions — that is, providing the public goods and services, the benefits and costs of which are primarily confined to the locality. While not all activities can be neatly compartmentalized (e.g., allocative decisions will affect distribution and stabilization, and local government may choose to undertake some programs chiefly for distributional reasons), the primary role for local government is clearly distinguished.

The implications of this assignment of functions for the range of activities performed by local governments can be quickly drawn. Social welfare is distributional and should be funded by the provincial and/or federal government. Similarly, the provision of health care involves a major redistributive role, as does a portion of primary and secondary educational expenditures. In the latter instance, however, considerable spillovers exist as well because many students eventually live and work in a community other than the one in which they received their education. It is important to distinguish between financial and delivery responsibilities. Services of a redistributional nature should be funded fully by provincial and/or federal governments and these authorities should contribute toward local services generating external benefits.[7] However, if these services can be delivered more effectively and efficiently by local governments, then the local governments ought to deliver them, although they are funded (largely or even entirely) by other governments. Conditional grants and/or intergovernmental contracts can be used to achieve the advantages of governments' joint involvement. Other functions, such as fire protection, public transit and recreation, are more clearly in the domain of local governments because the benefits and costs are internal to the community and redistribution is relatively minor. Finally, in order to control external effects, services such as sewage disposal and garbage collection face environmental standards to ensure that these spillovers are restricted and that treatment costs are borne by the source community.

Financing Responsibility

To approach the optimum quantity and quality of those services which are provided most efficiently at the local level, it is important that local decision makers be held accountable to their residents. That is, they must answer for the benefits and the costs associated with the delivery and financing of the goods they provide.

Given that provincial and/or federal governments ought to be responsible for income redistribution, the achievement of accountability at the local level is not an easy task. It is likely to be reached more readily, however, if taxpayers are able to relate their taxes and/or charges to the costs of services provided. This approach to a large extent parallels the private market. Consequently, it can be argued, street lighting, refuse collection, water provision and recreational services ought to be financed by a local government levy reflecting the costs of servicing the user. Indeed, it has been suggested that there is potential for greater use of benefit-based taxes at the local level (Bird, 1976). This observation is premised on the belief that demands for public services would be moderated and that the local public sector would operate more efficiently if the value of the benefits of locally provided public goods and services were related more closely to their costs. Benefit taxation functions reasonably well when the benefits and their distribution are clearly defined, the benefit charges are closely related to the costs of the services supplied, and income distribution is not a major concern nor much affected.

Regardless of the source of tax revenue, differences will exist in the capacities of local governments to provide public services. Variations in geographical location or features and in population size or composition among communities can create noticeable disparities in the costs of providing parallel services of a reasonable standard. Also, interjurisdictional differences in the tax base can often cause considerable variation in the tax rate necessary to fund similar services even when costs do not vary. Substantial variation in the fiscal capacities of local governments are widely condemned and provincial governments make transfers to equalize fiscal capacity or at least reduce the disparities, so that any remaining differences in tax burdens and public services result more from dissimilar tastes than from uneven abilities to finance local government. Because equalization grants are intended only to ensure adequate fiscal capacities to provide public services generally, they should be unconditional transfers. The efficiency implications of local interjurisdictional equalization (like provincial equalization) is still a subject of debate.[8] While such transfers maintain the public sector viability of poor or high cost localities and so occasionally avoid a socially undesirable exodus from a community (witness the deterioration of some U.S. central cities), they may sometimes be hampering desirable resource relocation or adjustment. Although equalization programs of one sort or another have been applied by the provinces to municipal governments, they have played a more important role in school finance.

Grants to provide adequate fiscal capacity may also be necessary to cover a fiscal gap. The purpose of such grants is to reduce a general discrepancy between the expenditure responsibilities and the taxing capacity of a level of government which leaves it unable to raise the revenue to match the expenditures required of it. These grants, too, should be unconditional.

For local governments, fiscal responsibility is best met when the revenues they raise are closely related to the benefits received by those who pay. Maintaining a clear and close benefit-cost linkage to the resident enhances fairness and efficiency. Not all revenues, however, need come from local sources. Interjurisdictional equity may warrant equalizing transfers, and as noted earlier, spillovers can justify grants to improve the efficiency of local public service supply. Grants to reduce or eliminate fiscal gaps are a possibility, but because they seriously erode the expenditure-tax link and are difficult to determine objectively, they deserve careful scrutiny in light of alternatives.

The Constitutional Status of Municipalities

Section 92(8) of the *Constitution Act, 1867* assigned exclusive responsibility for lawmaking with respect to "municipal institutions" to the provinces. Thus, municipalities can be created (reorganized or abolished) by the provinces, and whatever responsibilities and powers they have are determined by the province within the limits of its own authority. Most municipal activities result from the delegation of provincial responsibilities in the areas of local works, education, justice, hospitals and taxation. Because of the statutory and distinctly subordinate nature of municipalities to their provincial governments, municipalities are frequently characterized as "creatures" of the provincial governments. As a consequence of municipalities' subordinate position and provincial responsibility for municipal affairs, provincial-municipal relations are essentially administrative, with the province exercising direction and control mainly through its Department of Municipal Affairs and local authority supervisory boards as well as through the various departments dealing with functions involving municipalities, particularly education. Despite some municipal dissatisfaction with the subordinate role played by local government in the Canadian federation and certain efforts to change it (largely organized by the Federation of Canadian Municipalities), the constitutional position of Canadian municipalities remained unchanged under the *Constitution Act, 1982*.[9]

The Evolving Role of Local Government: A Predominantly Fiscal Perspective

The role of local government in Canada has changed substantially over time and continues to evolve. Various events, including rising incomes, technological change, urbanization and specialization in the workplace, have forced adjustments on all segments of society, local government included. The pressures for change have not always been homogeneous, and the timing and pattern of the transition have not been uniform. Yet, despite the resulting interprovincial variation, a substantial similarity remains among the activities and financing of local governments across

the country. A common underlying structure reflects both the purpose of local government and the strength of the federal system in its ability to accommodate different conditions and preferences and to experiment with alternatives. In the following seven subsections we shall examine some major national trends which reveal significant changes in the role of local government in Canada since the turn of the century, and draw attention to significant interprovincial differences in local governments.

The Local-Provincial Fiscal Balance

In the course of the twentieth century, local government relinquished to the provinces its dominant position in the combined local-provincial fiscal sphere. Prior to the 1930s, local governments both raised and spent more revenue than the provincial governments. In 1913, for example, net expenditure (i.e., excluding that financed from conditional grants) by local governments was almost $14 per capita compared with less than $7 per capita spent by the provinces. During the 1920s the provincial governments increased and, after World War II, grew — largely because of expanded services in health, education and social welfare — to surpass local budgets. By 1980, net expenditures per capita by local governments were about one-third those made by provincial governments, $696 compared with $2219.[10] This reversal is the consequence not of a smaller local government sector but of a much expanded provincial government sector.

The Growth of Local Government

While local government budgets have diminished relative to provincial budgets, the local government sector has grown relative to the rest of the economy. As shown in Table 6-1, between 1913 and 1981 net expenditures by local government increased from 4.3 to 5.7 percent of gross national product (GNP). Gross or total local government expenditures grew even more — rising from 4.4 to 8.7 percent of GNP over the same period. The major growth in local government came after World War II, when gross local expenditures relative to GNP more than doubled between 1947 and 1971. This growth was spurred by the need for replacement and extension of the local social infrastructure and the school requirements of the baby boom. The decline in local expenditures relative to GNP between 1971 and 1981 largely reflects the reduction in the school-age population occurring as the baby-boom generation matured.

Urbanization is often cited as a major reason for the growth of the local government sector.[11] Although the connection seems logical because the array and quality of public services found in urban areas typically exceed those in rural areas, the contribution of urbanization has often been overstated. While early studies of the determinants of local (or state and local) expenditures found urbanization (as well as income and grants) to

TABLE 6-1 Local Government's Share of Selected Economic Indicators

Year	Net Local Government Expenditure as a Percentage of GNP	Gross Local Government Expenditure as a Percentage of GNP	Local Real Property Tax as a Percentage of GNP	Local Real Property Tax as a Percentage of Personal Disposable Income
1913	4.3	4.4	4.0	n.a.
1926	4.7	5.0	4.2	5.5
1937	5.4	5.7	4.7	6.3
1947	3.4	4.5	2.3	3.1
1953	3.9	5.2	2.5	3.7
1961	5.7	7.5	3.7	5.4
1971	6.0	9.4	3.7	5.9
1981	5.7	8.7	3.1	4.6

Source: Calculated from data in the *Report of the Royal Commission on Dominion-Provincial Relations*, Book III, Sections 1 and 3 (1940); F.H. Leacy, ed., *Historical Statistics of Canada*, 2d ed. (Ottawa: Statistics Canada, 1982) and *Local Government Finance — Preliminary 1981 and Estimates 1982* (Ottawa: Statistics Canada, Annual).

Note: Net expenditures exclude those made from conditional grants received from other governments. Gross expenditures include those made from grants, in addition to own-source revenue.

be an important factor explaining per capita expenditures, the results of more recent work, having a sounder theoretical basis and better econometric specification, generally put little weight on urbanization as an important explanatory variable.[12] A good example is the well-known study on state and local expenditures by Borcherding and Deacon (1972), in which the tax price of public services, income and population are the major determinants.[13] In Canada, the wide disparity between rural and urban per capita expenditure has narrowed considerably, with urban expenditures only about 1.25 times those in rural localities in 1978 in contrast to about three times those in rural areas in the period from 1913 to the 1930s.[14] Between these two periods, expenditures per capita grew more rapidly in rural than in urban areas. Also, per capita outlays are high in cities and rural municipalities but low in towns and villages. This evidence casts doubt upon urbanization itself as a major contributor to local public expenditure growth and suggests that further study is necessary to identify the underlying forces.

The Increasing Importance of Conditional Grants

The growing spread over time between gross and net local expenditures as a percentage of GNP in Table 6-1 reflects the expanded importance of conditional transfers as a source of revenue to local governments. As a percentage of total local expenditure, conditional transfers represented

4.0 percent in 1913 and 6.2 percent in 1930 but had expanded to 17.1 percent by 1953 and to 40.4 percent by 1982.[15] The growth was particularly rapid during the postwar period when local expenditures also grew quickly. Without these transfers, much higher local tax rates would have been required to finance local outlays. Conditional transfers to local government come almost entirely from the provincial governments. Conditional grants are dominated by those for schooling, but grants for health and social welfare services are also important. Transfers cover more than one-half of local expenditures on each of these three functions. Although their share of the specific expenditures is smaller (25 percent), transportation and communication transfers are significant for local budgets. Specific purpose transfers from the federal government and its agencies represented only 1.5 percent of total transfers to local governments in 1980, and these grants have been declining in recent years.

The provincial governments also make unconditional grants to local governments, but these are relatively modest overall. In 1980, unconditional transfers were 9.8 percent of total transfers to local government and 4.4 percent of local government gross expenditure.[16] Conditional and unconditional grants together represented (in 1980) 45 percent of total expenditures, as opposed to about 23 percent in 1953.[17]

Local Governments: Municipal and School

It can be misleading to make inferences from local government data without distinguishing between school and other local (what we refer to as municipal) activities. In most provinces, local school boards operate as a major local government unit, effectively separate from municipal authorities. In these provinces, local school boards make expenditure decisions, have taxing power, and are treated as independent from the municipal government by the provinces. An indiscriminate lumping together of school and municipal authorities often impedes interpretation because the aggregate may reflect factors affecting one authority but not the other. Also, comparisons are made difficult because some provinces — New Brunswick, for instance — have assumed full responsibility for schooling, leaving only municipal governments as local authorities. Thus, for example, to note that local government relies upon specific-purpose grants to finance about 40 percent of its expenditures masks the fact that approximately two-thirds of school outlays are funded by transfers while conditional grants finance about one-quarter (28 percent in 1980, Appendix Table 6-A3) of municipalities' total expenditures. Unconditional grants are made only to municipalities and represent about 8 percent of municipal expenditures (so a total of 36 percent of municipal expenditures are funded by transfers). In 1953, transfers financed less than 20 percent of municipal outlays and just under 30 percent of school expenditures. In order to maintain as clear a perspective as possible in our discussion, we distinguish

school and municipal bodies and refer to the two together as local government.

Declining Local Responsibility for Health, Schooling and Social Welfare

The provincial government role grew most in the areas of health, education and welfare. These functions have evolved from areas of predominantly local to primarily provincial responsibility. The increasing significance of provincial conditional transfers, as for schooling, reflects only a portion of this major responsibility shift. Promoted in part by federal government programs, provincial governments have assumed direct responsibility for most aspects of health and social welfare services. Currently, four provinces have also accepted almost complete responsibility for school financing. During the first quarter of this century, local governments funded the majority of combined local-provincial expenditures in these areas; by 1980, however, local expenditures represented less than 10 percent of the total, with local financing of schools keeping the figure at that level.[18] Net expenditures by local governments for health, schooling and welfare now command a smaller portion of the local net budget, having declined to 30 percent in 1980 from about 51 percent in 1933 and 1953 and 39 percent in 1913.[19]

Although the local government role in social services has diminished sharply in a relative context, a parallel reduction has not occurred in real terms. Comparing 1953 and 1980 per capita expenditures (and using the index for government current expenditures as our measure of price change), local net expenditures for schooling, health and social welfare together have remained roughly constant in real terms while local net expenditures in total have increased (about 1.7 times). Thus, the diminished role of local government in the three areas has not caused any real reduction in financial responsibility since the mid-1950s. Rather, there has been only a relative decline resulting from expanded provincial services, although the provincial extension was often in areas directly under local control.

Reduced Reliance on the Local Property Tax

Local governments' dependence on their own sources of revenue has diminished. Owing to increased grants, revenue from local government sources has fallen from 96 percent of total revenue in 1913 to 54 percent in 1980.[20] The diminished reliance on local sources is largely reflected in the diverging trend in Table 6-1 between local property taxes, the mainstay of local government revenues, and gross expenditure as a percentage of GNP. The percentage of local gross expenditures financed by local property tax has fallen from about 90 percent in 1913, to 50 percent in 1953, to 35 percent in 1980.[21] Part of this change results from a shift away from

the property tax as a source of own revenue. After representing over 80 percent of own-source revenue up to 1953 (calculated from Appendix Table 6-A4), real property tax accounted for only 58 percent in 1980 (66 percent if business tax is included). Local governments have made a substantial move toward non-tax sources of local revenue (e.g., permits, net revenues from sales and fines). In 1953, non-tax revenues amounted to $5.37 per capita and 10 percent of own-source revenue, but by 1980 they were $214.68 per capita and 35 percent of own-source revenue.

Despite the declining importance of the local property tax as a source of local revenue, the burden of the property tax (when measured as a percentage of disposable income) has actually increased.[22] As a percentage of personal disposable income, local property tax increased from 3.1 percent in 1947 to 5.9 percent in 1971. This trend may have prompted political pressure for relief and the reform of local finance, which was chiefly manifested by the growth of conditional transfers, particularly in the late 1960s and early 1970s. By 1980, the local property tax burden had declined to 4.6 percent of disposable income, aided also by the reduced requirements for schooling.[23]

Interprovincial Variation in Responsibility

National trends mask the often considerable variation among provincial local public sectors. Local expenditures per capita range from $299 in New Brunswick to $1,823 in Alberta in 1980 (see Table 6-2). Relative to the $1,168 average, the per capita expenditures of three provinces (Newfoundland, Prince Edward Island and New Brunswick) are low while Alberta's is exceptionally high. The percentage of consolidated provincial and local expenditure accounted for by local government, 37.8 percent on average, reveals a similar pattern, but with Ontario ranking on top with 43.3 percent of expenditures at the local level.

The role of local government depends not only upon what it spends but also upon the revenues it must raise from its own sources. As a percentage of provincial-local expenditures, local own-source revenues average 21.1 percent, are a fairly uniform percentage (between 20 and 26 percent) in Ontario and western Canada, but are generally lower and vary widely (4.7 percent in Newfoundland to 17.5 percent in Quebec) in Quebec and Atlantic Canada. Own-source revenue per capita ranges from $109 in Prince Edward Island to $853 in Alberta, with lower values east of Ottawa and larger values to the west. Own-source revenue usually represents about one-half of total local revenue, but the share varies from less than 20 percent in Prince Edward Island to almost 70 percent in British Columbia.

Interprovincial differences in the degree of provincial responsibility for schooling provide the major reason for the variation in local expenditures and revenues. Schools are funded entirely by the province in New Brunswick and almost entirely in Newfoundland. Hence the per capita

TABLE 6-2 Interprovincial Variation in the Local Public Sector, 1978 and 1980

	Gross Local Expenditure as a Percentage of Provincial and Local Expenditure, 1978	Gross Expenditures ($ Per Capita, 1980)			Own-Source Revenue as a Percentage of Provincial and Local Expenditure, 1978	Own-Source Revenue as a Percentage of Total Local Revenues, 1980	Own-Source Revenue ($ Per Capita, 1980)			Provincial Government Grants to Municipal Governments ($ Per Capita, 1980)	Unconditional Grants as a Percentage of Total Provincial Government Grants to Municipalities, 1980
		Local	Municipal	School			Local[a]	Municipal	School		
Newfoundland	7.4	317	294	23	4.7	62.1	171	148	23	66	43.1
Prince Edward Island	26.2	579	160	419	10.5	18.6	109	108	1	45	39.4
Nova Scotia	33.5	989	511	478	14.2	36.4	345	128	217	290	36.1
New Brunswick	12.4	299	299	0	7.5	54.2	151	151	0	112	78.4
Quebec	35.5	1206	638	568	17.5	41.2	481	453	28	103	22.5
Ontario	43.3	1172	677	495	24.5	54.6	649	426	223	239	25.9
Manitoba	38.5	1082	624	458	23.3	57.2	626	414	212	178	24.7
Saskatchewan	38.2	1138	668	470	20.4	51.4	574	378	196	269	21.1
Alberta	42.5	1823	1306	517	24.5	53.1	853	634	219	354	11.1
British Columbia	36.5	1071	608	463	25.6	69.4	702	400	302	115	45.8
All Provinces	37.8	1168	684	484	21.1	51.6	584	419	165	191	25.6

Source: Local Government Finances (Actual), 1980 (Ottawa: Statistics Canada); and *Consolidated Government Finance, 1978* (Ottawa: Statistics Canada).

a. Excludes grants in lieu of taxes from provincial and federal governments.

local school expenditures in these provinces of $0 and $23, respectively, contrast sharply with the $484 all-province average, which is fairly typical of school expenditures in the other provinces. Even where local school expenditures are substantial, provincial transfers account for the majority of the funds — leaving local units to raise almost $200 or more per capita from own sources. However, in two provinces, Prince Edward Island and Quebec, school grants account for almost all the school expenditures at the local level, with only $1 and $28 per capita raised from local sources. In contrast, British Columbia puts an unusually large absolute ($302 per capita) and relative (over 60 percent) burden for school finance on local sources.[24]

Interprovincial variation also results from differences in municipal responsibilities. Municipal expenditure per capita is particularly low in Newfoundland, Prince Edward Island and New Brunswick, less than one-half the average over all provinces. Local governments in these provinces have essentially no responsibility for health or social welfare. Even when account is taken of the fact that provincial transfers to municipalities are relatively more significant in Nova Scotia, local governments in all of the Atlantic provinces have a more modest role than those elsewhere in the country; per capita revenue from own sources ranges from $108 to $151 in comparison with $378 to $634 elsewhere. Per capita municipal expenditures are almost uniformly lower for all functions in Atlantic Canada.[25] Also in Atlantic Canada, the provinces (Nova Scotia and New Brunswick particularly) tend to rely more upon unconditional funding to support municipal governments than elsewhere in Canada, and especially Alberta. Perhaps because of their relatively small size, sparse settlement and concern for standards of service, central provision by provincial governments has come to play a more important role in that area. Rural local authorities do not exist in New Brunswick and Prince Edward Island. At the other extreme, the high per capita expenditures and revenues in Alberta in 1980 can largely be attributed to the combination of rapid growth and affluence (particularly of the provincial government) during the 1970s. Declining fortunes in Alberta will likely result in the fall of these figures toward the norm.

Intergovernmental Problems at the Local Level

Local governments often feel that their role is overly constrained. Many of the problems they face are viewed as stemming directly from their constitutional status. Because local governments are fully subservient to provincial governments, there is extensive (some would say excessive) provincial involvement in local affairs. Provincial governments have determined and redetermined what activities local governments undertake, how they are organized to do them, and how they are financed. Their involvement has been so great that local government typically feels that its responsibilities and autonomy have been eroded. Charged with responsibility for local

government, the provinces, however, argue that these developments have been necessary to ensure the efficient and equitable provision of services. These issues are discussed briefly in this section on intergovernmental problems.

Shifting Responsibility

Provincial governments have expanded upon and/or taken over important functions which previously had been predominately local responsibilities. Schooling, health and social welfare are the prime examples. In some cases the province has assumed full responsibility for delivery and funding, but in others, notably schooling in most provinces, the province provides most of the financial support while the local unit retains (ostensibly) responsibility for providing the service. While this mixed arrangement affords a greater element of local input and control, it does cloud the issue of responsibility to the user and the taxpayer-voter. Local delivery often characterizes those services which are financed entirely by the province — hospitals, for example. In both these situations, local authorities may become frustrated because citizens' confusion over responsibility results in complaints about services being directed toward them when in fact they have little if any control. Despite the growth in the overall fiscal impact of local government, these shifts in responsibility have meant that local decision makers have felt some loss of authority at the local level. Regardless of the other merits, these shifts may have caused local resentment, but more importantly, they have resulted in a loss of control over, or a perceived insensitivity to, matters which still retain local importance.

Provincial Supervision

Provincial governments often have a major voice in local government operations. They may require that certain services (e.g., police, fire protection, ambulance, sewage treatment, waste disposal) be provided, at least in certain communities, or dictate the standard of service that must be met. Sometimes these requirements may be warranted because of spillover effects beyond the community, but not always. If not, provincial requirements can unjustifiably conflict with local priorities.

The provinces supervise closely the financial affairs of local governments. Local governments are not allowed to budget for an operating account deficit. Capital budgets are also closely scrutinized. The nature and mechanism of control vary widely among the provinces, but the situation is that local authorities in all provinces are required to obtain provincial approval before undertaking long-term borrowing.[26] All provinces, however, provide local governments with some form of assistance in raising capital, ranging from assistance in marketing local debentures to subsidized loans.

Special-purpose bodies may be required by the province to manage certain activities. Boards of education are the most obvious example, but special authorities often also exist for police, libraries, health and recreational facilities, utilities and public transit, among other services. Separate authorities have been justified as the means of providing expert decision makers, interjurisdictional coordination, and insulation from political intervention. However, the proliferation of special-purpose bodies with considerable autonomy and financial independence in their own areas has often been found to fragment responsibility and hamper coordination because they could by-pass or ignore the local council (Plunkett, 1968, p. 60; Tindal and Tindal, 1979, pp. 81–82). Though still plentiful in some provinces, special-purpose authorities are now looked upon less favourably. The elected local councils are better suited to set the overall priorities and make the necessary trade-offs among these and other local activities.

Conditional Transfers

Conditional grants are a major source of provincial influence on local decisions. By reducing the local costs of specific services, conditional grants may lead to greater expenditures in the favoured areas. The growth in the importance and number of conditional transfers has been seen as reducing local autonomy and distorting local priorities.[27] While the problem is serious, it is less serious than is suggested by the often-quoted fact that local governments rely on specific-purpose grants for over 40 percent of their revenue. Grants for education account for two-thirds of the total conditional grants to local governments. Because most of those funds are generally distributed on a per student basis to single-purpose local school authorities which raise the remainder of the funds needed from local taxation, the impact of education grants is more like lump-sum aid and likely causes little distortion among different kinds of school expenditures or between school and municipal expenditures. However, in Ontario, for example, some school grants apply only to certain recognized expenditures, and there is likely to be a distortion among different types of school expenditures. The extent to which school expenditures are increased by education grants may be warranted on the basis of improved equality in educational opportunity and the spillover of broader social benefits from children's education.[28]

The increased use of conditional grants poses some problems for local governments. Particularly troublesome is the vast array of specific aid programs (often applying to almost every local activity) and the variety of conditions attached to them; for example, Alberta and Ontario have more than 70 conditional grant programs (McMillan and Plain, 1979; Slack, 1981). Such a system might be acceptable if the grants were designed to improve the efficiency of the municipal public sector by correcting for

distortions caused by interjurisdictional spillovers, but typically it is difficult to rationalize the extent of the funding and the particular conditions on that basis. The number and variety of grants have created a confusing maze which is costly for the local units to navigate in order to play the grantsmanship game (perhaps benefiting the larger and richer municipalities) and which is expensive for the provincial governments to administer (Ontario, 1977a). The fact that provincial programs are offered by many provincial departments without coordination or review, and are aimed at a variety of local governments and special-purpose authorities, contributes to grant structures which are difficult to comprehend and which defy serious rationale.

Conditional transfer programs are often defended on the grounds that they assist the financially hard-pressed municipalities. If general financial support is warranted, however, it should be provided unconditionally. This fact, plus the criticisms of the prevailing conditional programs, has argued for reform of the grant structure with emphasis on deconditionalizing provincial transfers. Proponents of this argument have met with relatively little success. Conditional grants continue to dominate in most provinces, and those in which unconditional grants are more important generally provide less support to municipal governments.[29] The reluctance of provincial governments to deconditionalize their grant structure may stem from a political desire to maintain as much control as possible over the funds they dispense. A particular provincial department is concerned that the funds it transfers to municipalities are spent on the activities it promotes, but the argument from the overall provincial government level is less compelling, particularly if, as is often claimed, it is chiefly interested in local fiscal capacity. It is certainly doubtful whether the provincial visibility and accountability provided can justify the complicated grant system.

Tax Base and Revenue Sources

Local governments often argue that the limited tax base allowed them has prevented and still prevents them from meeting their mandate. Heavy reliance on the property tax, which is both inelastic with respect to rising incomes and unpopular because of its perceived regressiveness, left local governments unable to respond adequately to the postwar increases in demands for services — particularly school, health and social services. As a result, the provincial and federal governments with access to more progressive and elastic tax sources assumed responsibility for these services, either directly, by providing them, or indirectly, by supporting local provision with conditional grants. The lack of an adequate fiscal base is seen by local governments as having (i) unduly limited their role in areas where the provinces have assumed greater responsibility but where local

input is felt to be important; (ii) reduced local autonomy in the provision of purely local services owing to the necessity of depending upon conditional transfers; and (iii) left local government weakened and unable to respond to legitimate local issues because of the fiscal gap between expenditure requirements and revenue-raising capacity. The result has been calls for local access to other revenue sources, usually via some program for the sharing of provincial revenues.

Consultation

Particularly troubling to many local governments is the lack of consultation with the province. Not only does the province direct their affairs, supervise their activities, and help fund many of their programs, but many of these decisions are made without what is considered to be adequate consultation. Too often local governments feel that by the time they hear of a change, it is already a fait accompli. Consequently, their concerns, advice and insight are largely ignored, and the programs seem less satisfactory than if developed with more mutual input. Provincial insensitivity to local interests and opinion can be quite irksome.

A Provincial View

Recognition must also be made of the provincial governments' perspective on the concerns of local government. The provinces are responsible for local governments. Consequently, the province can be expected to involve itself in supervising local activities so as to reduce the possibility that local units will fail to function properly or run into financial difficulty — a role which some unfortunate experiences, during the 1930s especially, promoted. This involvement is in some instances quite valuable and may sometimes be appreciated. Local governments vary widely in their size and the resources available to them. While some are larger than the small provinces, most are small and many lack the scale to benefit from substantial expertise in the elected or appointed local officials. To many smaller units, the provincial supervision may provide an economical and convenient source of advice. The provincial involvement is also motivated by the fact that if a locality did encounter problems, it is the provincial government that would likely be turned to for relief or rectification, even if it were not formally responsible for the local authority. The broader political and economic base of provincial authorities provides them with a perspective and capability, even in the absence of a specific mandate, to cope with local issues. The problem is, of course, to construct that mixture of provincial-local relations which protects the legitimate interests of the province without unduly hampering local jurisdictions.

Overview

We have noted a number of concerns about local intergovernmental relations, most of which have been expressed by local governments. In particular, the restricted fiscal base is seen as having limited the role of local government and eroded its autonomy by forcing excessive reliance on conditional transfers from the provinces. Provincial directives and mandates are also of local concern. The fact that many of the provincial interventions occur with a minimum of provincial-local consultation can be most annoying. Other issues of concern include the problems of local budgeting when relying heavily upon provincially determined grants and the provincial repression of federal-local interaction. It is interesting to note that many of these same concerns were reported by writers on local government 30 years ago (Brittain, 1951, pp. 144–47; Crawford, 1954, chap. 17), although their relative importance may have changed somewhat.

Facing the Future with the Existing Institutional Arrangements

In many ways, local governments have experienced an unenviable past. Growth in the demand for local services surpassed the generally accepted potential for traditional revenue sources to finance these expenditures. Senior governments intervened by assuming greater responsibilities, especially for social services, and by extending substantial financial assistance. Part of the result is a service structure often dominated by provincial directives and involving complex intergovernmental relations and a legacy of conditional grants. What are the prospects if we continue with the existing arrangements? Is this situation likely to change and, if so, how?

During the postwar period, heavy demands for local public infrastructure and for schooling put considerable pressure on local finances. Those demands are reflected in the trends reported in Table 6-1 and were exceptionally high in 1961 and 1971 despite the shifts in responsibility and financing which were evolving. However, it is not anticipated that the relatively high expenditures for social infrastructure which prevailed throughout the 1950s and 1960s will recur. As well, virtually every population projection for the next 40 years suggests that the school-age population as a proportion of total population will decline. (See Table 6-3 for one specific population projection.)

While demographic change and population composition is only one of a multitude of determinants of local government expenditures, it is nevertheless an important determinant. In the mid to late 1960s and early 1970s, an unusually large cohort of young people began a wave-like movement through the age pyramid. Initially, this required an expansion of the school system. More recently, it has required an expansion of employment opportunities, housing, and related services, and by 2026 it will involve an expansion in expenditures catering primarily to retired citizens.

TABLE 6-3 Age Distribution of Canada's Population, 1976–2026 (percent)

Year	0–17	18–64	65+
1976	31.9	59.4	8.7
1984	26.9	63.2	9.9
2001	23.5	64.4	12.1
2026	19.6	61.4	19.0

Source: Population Projections for Canada and the Provinces, 1976–2001. Occasional Publication 91-520, Statistics Canada (Ottawa: 1981), Projection #4.

The substantial changes occurring in the population profile is shown in Table 6-3. Between 1976 and 2026 the percentage of the population under 18 years of age will decline sharply while the proportion of the population over 65 years will increase. By comparison, the percentage of the population between ages 18 and 64 will remain virtually unchanged. Overall, the expected composition of the dependent population (under 18 and over 65 years) shifts from predominantly youth to approximately equal numbers of youth and aged.[30]

Since local government expenditures have been oriented toward the young rather than the elderly (for whom the federal government incurs the bulk of government expenditures), the shift from a relatively young to a relatively older dependent population may have noticeable implications for local government finance. For example, if the programs of the mid-1970s were retained, over the next 35 years the growth of local government expenditures attributed to population growth and population aging would be modest and noticeably lower than for either the federal or provincial governments.[31] One consequence of a more elderly or retired population, with their below-average incomes, is that a given property tax levy will impose a greater relative burden. At the same time, a relative reduction in the school-age population implies that (i) fewer resources will be required for financing education, so school taxes can decline; (ii) there is a relatively larger non-school population over which to spread the costs; and (iii) these people will demand more non-school services. Using reasonable assumptions, it is possible to predict the impact of the projected demographic changes upon the burden of local taxes relative to personal disposable income. If the structure of local finance existing in the late 1970s prevailed but the demographic composition of the population was that of 2026 rather than that of 1976, then local taxes as a percentage of personal disposable income would decline from about 5.2 to 4.4 percent. This latter figure is only slightly less than the 4.6 percent value already reported for 1981 in Table 6-1, partly because the school-age population is declining. In the near future, some further reduction may be expected because only about 40 percent of the projected 50-year reduction in the 0–17 age group occurred by 1984. While other events may intervene, these results do indicate that the expected shifts in the demographic composi-

tion of the population should, on net, serve to reduce the fiscal pressures on local governments.[32]

A larger retirement group will exert more political influence and seek both further reductions in services from which they obtain little benefit (e.g., schooling) and higher expenditures for services to the aged (e.g., recreation and culture, public transit, housing for seniors). Single-parent families are expected to increase from 8.8 percent of all families in 1976 to 11.9 percent in 2001.[33] This development will likely expand the demand for child-care centres and hence increase local government expenditures in this area. Continuously high levels of unemployment may augment social tension, which will have to be offset by further expenditures by local governments on social or protective services. The effects of these services are difficult to predict, but given the magnitude of local expenditures on these items (relative to schooling, for example), the consequences are unlikely to be major.[34]

These results suggest a slight moderation of local fiscal pressures if the existing arrangements continue. Without the burdens encountered from the late 1950s to early 1970s there is likely to be only limited political pressure to alleviate the local fiscal burden. Indeed, the pressure mounting for a reversal may be tied to temporary, adverse economic conditions. The recent fiscal restraint of provincial and federal governments suggests that grant support is unlikely to grow as quickly in the future. In fact, for many services, grants are likely to grow less quickly than the corresponding increase in local expenditures required to maintain the same quantity and quality of service. If grants become more limited and the resistance to higher taxes continues, then local governments will be forced to cut back on services or place greater dependence on user charges or some alternative source of locally generated revenue less visible than the property tax.[35] Alternative revenues are more likely to be used if people-oriented services are at stake, since the linkage between property taxes and benefits is nebulous at best. Some services will probably be reduced, but local residents may be prepared to maintain or even expand others if a greater share of the cost is met through a fee-for-service. In many cases, shifting toward a charging policy would improve the allocation of local government resources. However, there remains some concern that services of general benefit but not closely related to the property tax will be undersupplied.

Continuation of the current financial structure, with its existing tax base and unnecessary conditional grants, limits local autonomy. Reform of the property tax system, making it less regressive and more allocatively efficient, could, however, expand its use. Indeed, the issue of property tax reform and the possibility of introducing alternative revenue sources have generated a considerable amount of interest among civic officials.

An Assessment of Issues and Alternatives

The role of Canadian local governments has changed significantly as a result of the tremendous demands put upon them and provincial efforts to ease those burdens. Although the pressures to which local government is likely to be exposed in the immediate future seem to have abated, continuing concerns for many practical problems and remaining conceptual difficulties suggest that improvements are still possible. We consider some of those possibilities here, focussing on the reassignment of responsibilities, local property taxation, and alternative revenue sources, and the modification of intergovernmental relations.

Reassignment of Responsibilities

It is often argued that a better fiscal balance would result from a reassignment of certain local responsibilities. However, with social welfare and health now financed predominantly by the provincial and federal governments and schooling by the provinces, the major reallocation appears to have been achieved already. Thus, the potential for further reassignment is limited, although exceptions do exist for some functions in specific provinces.

The transition so far witnessed has been consistent with the theory of fiscal federalism — that is, it has been those functions which involve a redistribution of income of significant externalities which have been adopted by the provincial governments. However, provincial assumption of responsibility through full funding or extensive conditional grants tends to convert the local government into an agent of the province and may, if not carefully structured, reduce sensitivity to local needs and preferences. In some services this development presents little difficulty, but in others (schooling being the most likely), local interests and intercommunity variation in preferences require considerable local input and some local financing. The provincial funding of schooling, as in Prince Edward Island and Quebec, then, may not be acceptable across Canada, and it may be wise to consider other arrangements, such as grants, to correct for spillovers and to equalize outputs and fiscal capacities among local units.

At this time, other than for some possibility of greater provincial funding of schooling, the potential for further reductions in local responsibilities seems limited. The few potential candidates (e.g., low-income housing, day care) already receive substantial provincial support and benefit from local management. Indeed, given the declining fiscal fortunes of provincial governments and their problems with the management of programs such as health care, it is conceivable that the provinces, purportedly in the interests of achieving greater accountability, may be tempted to unload

part of the cost or responsibility for some services either through greater private sector involvement or through local governments.

Local Government Revenues

Difficulties with raising revenues from local sources, in addition to distortions created by local taxes and dissatisfaction with grant programs, have led to suggestions for changes in or additions to the local revenue base. These suggestions have ranged from demands to adopt new revenue sources, to altering the current grant structure, to improving the efficiency of the existing local property tax. The reassessment of local own-source revenues may prove important if provincial support of local governments were to diminish and local governments were required to rely more upon local sources.

The Local Property Tax

The property tax, if properly designed, has been defended on numerous occasions as being a good tax for local governments.[36] It raises substantial revenue with relatively low costs of administration. In a rough way, it can relate some benefits to costs. Moreover, recent property tax relief schemes have eliminated a considerable amount of the alleged regressiveness of the tax. Despite these virtues, and indeed there are others, local property taxes have been criticized on a number of fronts. Most of the criticism is of a practical nature and revolves around the current application of the tax rather than the use of an ideal property tax designed according to the benefit-taxation rationale.

Turning to the actual application of property taxes, the lack of consistency in intermunicipal and intramunicipal market value to assessment ratios is a major problem. This inequity has been partially corrected through provincial involvement in the assessment practice; however, a number of major inequities between different classes of property still remain.[37]

Consistent and uniform assessment practices in communities composed of a relatively homogeneous class of properties allow property taxes to approximate benefit-based taxation. But, if the tax base is heterogeneous, the correspondence between local benefits and local taxes diminishes sharply. This problem is observed most clearly in the comparison between residential and non-residential property. Non-residential property typically bears a larger local tax burden for three reasons: first, assessment to market value ratios tends to be higher for non-residential property; second, a higher mill rate is typically levied on non-residential property in provinces permitting a split mill rate (these include Ontario, Manitoba, Alberta, New Brunswick, Prince Edward Island, Nova Scotia and British Columbia); third, a municipal business tax is often imposed on top of the non-

residential property tax. When combined with the fact that the residential sector requires larger expenditures for local services than the non-residential sector,[38] the existing inequities and misallocation of resources become obvious.

One consequence of shifting a disproportionate share of the local tax burden onto the non-residential sector is to reduce the tax price which residential property pays for the services it consumes. This reduced tax price creates a greater demand for residential services than if residential property paid the cost of its own services. A second consequence is to shift part of the local tax onto the consumers of goods and services produced by the non-residential sector. Such shifting transforms the nature and local incidence of the tax into one which may have undesirable distributional effects. In addition, much of this tax may be exported beyond the locality.[39] While popular on political grounds, this shifting of the cost of providing local services to non-residents creates interjurisdictional inequities in fiscal capacities and promotes overspending on local services. Such tax externalities justify provincial action to reform the taxation of non-residential property and/or equalize the fiscal disparities it causes.

This disproportionate tax on non-residential property has led to demands for restructuring of the local property tax so that taxes paid more closely approximate benefits received. Ideally, this would involve greater reliance on the user-fee principle; that is, recipients of local services would pay a price (user fee) which covers both the extra cost of producing or supplying the last unit of local services consumed and the extra cost of any damages (externalities) created in the production or consumption activities of private individuals or firms.[40] However, there are practical and administrative problems in clearly identifying the specific benefits accruing to specific kinds of properties.

Distinguishing between property-oriented and people-oriented services raises further issues about the benefit relationship of the property tax. The property tax is most appropriate for financing services benefiting property, since the linkage between the tax and benefits is often fairly close and visible. However, there may be little or no direct connection between the benefits of people-oriented services (education, social programs) and the individual property-owner's taxes. The resulting disparity which the local taxpayers perceive between local taxes and benefits hinders their willingness to accept tax and expenditure increases.

As long as property taxes are used to finance both people-related and property-related services, it may be reasonable to consider a two-part property tax system. One part would be based on the benefit principle and designed to cover the cost of property-related local services. This portion could consist of a collection of user fees for different services or be raised as property taxes designed to approximate the cost of services to the property. If property taxes are used instead of user fees, the tax rates could vary by type or category of property as long as it is true that dif-

ferent categories of property receive different benefits. This part of the property tax system would apply to both residential and non-residential property. The second part of the property tax would apply to residential property only and would be designed to cover the costs of providing people-related services. Because it is impossible to assign these benefits to property, this part of the tax would, by necessity, be based on market value. Hence, under this system, all property pays for property-related services on a benefit basis, while residential property only is taxed for people-oriented services.[41]

With few exceptions, the distinction between property-oriented and people-oriented local services is not straightforward. Because of this blending, and the smaller magnitude of people-related as opposed to property-related services, the two-part tax may function satisfactorily for most municipal services. Since schooling, however, is clearly people-oriented and is a major cost to local taxpayers in most provinces, it is pertinent to consider reducing or even removing school finances from its dependence on local property taxation. An obvious alternative is to shift full responsibility for schooling onto the provinces, though responsiveness to local interests would then be difficult to maintain. Alternatively, because education and income are closely related, it would be possible to use a local income tax (equalized as school property taxes are now) to finance the local share of education.[42] Removal of local school funding from the property tax would leave municipal governments, whose services are closely related to property, with greater tax room.[43]

Taxpayers' reaction to the property tax is tempered by the perception that the property tax is not closely correlated to ability to pay and, indeed, that it is regressive. Assessments of the property tax incidence under various assumptions reveal regressiveness of the tax at all but perhaps the highest income levels (e.g., Bird and Slack, 1978; Thirsk, 1982). This regressiveness would be less of a concern if the property tax were closely related to benefits.[44] In recent years, various measures introduced in several provinces to aid property taxpayers have had the effect of reducing the regressiveness of the tax. While these measures include grants, exemptions and credits, tax credits applied to income tax liability appear to be the most effective, though there is criticism here.[45]

A number of improvements have been made to the current property tax system over the past few years in assessment, administration and relief. Nevertheless, deficiencies remain and further improvements should be sought; for example, removal of the discrimination against non-residential property and greater dependence on the benefit principle would be desirable. For reasons of interpersonal and interjurisdictional equity, provincial initiative and supervision will be required for reform. Although the property tax is well suited to local government finance, it already bears a heavy load in many provinces and is highly visible. While visibility promotes accountability, it also generates resistance to tax increases even if

these increases are legitimate on benefit, equity, and allocative efficiency grounds. Given the political response to property taxation in the United States and the likely opposition to higher effective rates in Canada, it is wise to consider some alternative sources of local revenue.

Alternatives to the Property Tax

It may be possible, even advantageous, for local governments to employ alternative sources of revenues. Some of these options, such as user charges, could be employed with local initiatives, but others, such as local sales or income taxes, would require the cooperation and/or consent of provincial governments.

User Charges

It is often argued (Bird, 1976; Bird and Slack, 1983) that, despite their expanding importance, local governments could employ user charges to a greater extent. The rationale for extending user charges is that they would afford a closer correspondence between the benefits and the costs of local services than does the general local tax system and so, through a quasi-market system, guide both the demanders and suppliers of many services toward the more efficient use and provision of services. Several services are easily identified as potential candidates — utilities such as water and sewage, as well as refuse collection, recreation services, and fire protection (Bird, 1976). While distributional concerns may explain some reluctance to exploit user charges, it is not at all clear that their use has adverse distributional implications. Furthermore, if distributional problems were created, they could be more efficiently and adequately handled by provincial and federal income transfer programs. In any case, user charges of various sorts are of increasing importance in local government budgets (Kitchen, 1984).

Less often mentioned in connection with user charges are transportation services. Although they represent about one-fifth of municipal outlays, motor vehicles are rarely taxed locally to support these services. Obviously there are difficulties with levying local charges on motor vehicles, but there is a strong argument for a coordinated approach with the provincial governments, possibly resulting in a sharing with the municipalities of fuel taxes and licence fees to support local transportation expenditures.

Local Sales Taxes

While local sales taxes have not been employed in Canada since 1964 (until this time, they were used in Quebec), they are a popular and important source of local revenue among local governments in the United States. The merit of a local sales tax, however, appears to be only its revenue-raising capacity and the fact that administrative costs can be minimal if it is "piggybacked" onto a provincial sales tax. There are several negative

arguments which we regard as overwhelming: (i) interjurisdictional differences in local sales tax rates can distort location and economic activity; (ii) the incidence of the sales taxes is likely to be regarded as no better than that of the property tax; (iii) there is a minimal relationship between the burden of the tax and the benefits of local expenditures (partially because often a considerable portion is exported); (iv) there are large disparities among municipal sales tax bases which could imply that interjurisdictional fiscal disparities would actually increase as a result; and (v) rural municipalities are particularly disadvantaged. Thus, while a local sales tax offers some scope of additional local revenue and local autonomy, it does nothing to enhance local responsibility or to improve on the efficiency or equity of the local finance system. Sales taxes are best left to other levels of government and, if used to support local government, done so through a scheme for sharing provincial sales tax revenues, preferably via the vehicle of unconditional grants.[46]

Local Income Taxes

Many authors have considered the possibility of a local income tax as an alternative source of local revenue.[47] Local income taxes are the predominant local tax source in Scandinavia and are common in many cities in the United States. Many Canadian local governments employed local income taxes, usually as a relatively minor revenue source, prior to 1941, when federal-provincial arrangements eliminated that option.

Local income taxes could be readily implemented with federal and provincial cooperation. Locally established rates could be added as a surcharge on the federal or provincial income taxes and collected along with other income taxes. Piggybacking onto the existing schemes minimizes the administrative costs and affords the most comprehensive and equitable tax base. The attractiveness of a local income tax diminishes substantially if it must be locally administered. The fair treatment of commuters poses a difficult conceptual problem but as a practical matter is usually handled rather arbitrarily, as when the revenue is divided equally between jurisdiction of residence and work. It is usually recommended that corporate income not be taxed so as to avoid tax exporting. If corporate income is to be taxed to support local government, it is better done by the provincial government and used to fund general transfers to local governments. Whereas for accountability reasons it is attractive to have each locality set its own income as well as property tax rate, much of the advantage would be gained at a lower collection cost if only the larger municipalities set their own rates and the smaller localities had a common rate set on their behalf in a revenue-sharing kind of arrangement.

There is some merit in having income taxes as a component of the local tax system. The incidence of the income tax varies significantly from that of other local sources, especially the property tax, and therefore offers a way of modifying substantially the distribution of the local tax burden

(to that which may parallel more closely the benefits of certain services) while at the same time providing the municipality with a more elastic revenue base. The possibility of employing local income taxes to support the local contribution to school finance has already been noted.

Expanding the local tax base via local income taxes would increase locally raised revenues and reduce the need for grants (at least, in total). Provinces then could justifiably reduce their multitude of conditional grants. The province's equalization role, however, would continue to be important, because both income and the traditional local revenue sources would require equalization.

An expanded tax base and greater reliance on local revenues would make local government more accountable. The link between local expenditures and local revenue would be more direct than when transfers exist. When the funds to be spent must be raised by the same unit, they are more likely to be efficiently utilized because their use must be justified to the local taxpayers.

Whether local autonomy would increase as a result of such a change is not clear. The possibility of greater financial independence argues in favour of more autonomy but must be accompanied by proven local responsibility if provincial authorities are not to employ a variety of other controls which could more than offset these gains. Certainly the opportunity would exist for the removal of many controls which have proven to be especially distasteful, a change which could prove advantageous for both local and provincial governments.

While a local income tax offers some advantages, it is not clear that local residents would necessarily find it to their advantage. If the local income tax falls on personal incomes as recommended, there is little opportunity for shifting the tax to non-residents. Hence, local residents in some communities may find that improving the linkage between local taxes and benefits actually works to their disadvantage (Becker and Isakson, 1978; Oakland, 1979).

Concern is sometimes expressed that differentials in local income taxes would distort locational decisions because households and firms would choose to locate in the lower tax area. Where local income taxes exist, there is little evidence that this is a serious problem (Rodgers, 1981) and none to suggest it is any more important than the relocation induced by property tax differences. The central city–suburb movements in the United States provide ample evidence of the problems and distortions stemming from the latter. Households will determine their location on the basis of the local tax-expenditure package. A proper assignment of responsibilities and fiscal equalization is likely to be more important for preventing inefficient location decisions.

In any consideration of intergovernmental fiscal relations the local income tax deserves careful thought. It should not replace the local property tax, nor become as important a revenue source for municipal

government. It provides a different dimension to local finance, which may enable local decision makers to relate more closely and to balance revenues and expenditures more satisfactorily. At the same time it may offer some scope for increased local autonomy, but only while demanding more local responsibility. In the opinion of one leading economist, "There is a good chance that the enactment of a local income tax . . . would indeed tend to substitute a more equitable, efficient and growth-sensitive tax for the general property tax" (Break, 1970, p. 101).

Intergovernmental Transfers

The expanded fiscal pressures under which local governments laboured for many years during the post-1945 period were eventually eased by the expansion of provincial transfers. Too often, however, a complex conditional grants system emerged which left local decision makers facing a multitude of special incentives distorting local preferences. Assessments of the provincial-local grant structure which evolved, and still prevails in most provinces, criticize the excessive reliance on conditional grants.[48]

The strongest justification for conditional grants arises where significant externalities exist. At the local level this is most noticeable for expenditures on education, health, and social welfare programs. For many other services, externalities are far less significant and in some cases simply nonexistent, yet conditional grants still remain, although they are a considerably less important source of funds. Although the overall pattern of grant support for local functions tends to conform in a rough way with the extent of externalities, the total grant structure is so complex, with its multitude of restrictions and conditions, that it is difficult to comprehend and decipher.[49] Indeed, most of the grants cannot be defended according to the economic rationale of fiscal federalism.

Given the economic and political distortions caused by conditional grants and the basic costs (both to the donor and recipient) of managing them, it is hard to believe that their visibility justifies their number or the volume of funds allocated. Furthermore, all too frequently, the stated purpose of these grants is to improve the fiscal capacity of recipient governments. If so, the more efficient way of meeting that objective is with unconditional grants.

The importance of conditional grants in the provincial-municipal transfer system may be partly a consequence of a piecemeal approach by provincial governments and their various departments to the fiscal problems of local governments as they have developed. In any case, the complications caused by the excessive and inappropriate use of conditional grants are well recognized and warrant reform. While a number of analysts have recommended modification of the grant programs in many provinces, provincial authorities have been less interested in making such changes. Conditional grants dominate the transfers to municipal government, often to a very large extent. However, some innovative unconditional grant pro-

grams have been developed. Two provinces, British Columbia and Saskatchewan, have introduced revenue-sharing schemes. Through these plans, a portion of provincial revenue from personal and corporate income taxes, sales taxes, resource taxes (British Columbia), and fuel taxes (Saskatchewan) are used to finance a pool of funds which is distributed to municipalities on an equalized basis. Manitoba has established a tax-base-sharing program under which one percentage point of the corporate income tax and 2.2 percentage points of the personal income tax are designated as municipal income tax.[50] The funds are distributed by the province as transfers, largely on a per capita basis. While these programs have served to refine the funding and allocation of unconditional assistance, they have not resulted in major changes in any province's total grant structure.

A significant restructuring of grant programs and transfer policies appears to offer significant potential benefits in many provinces. To some extent a lead may be taken from the federal-provincial programs, where transfers are less restrictive than most provincial-municipal programs, equalization plays a more important role, intergovernmental consultation is important (though the donor's preferences clearly dominate), and programs are periodically reviewed. The same arguments which the provinces have made as recipients of federal grants are often not accepted when advanced by the municipalities. Many conditional grant programs could be terminated and the funds shifted to unconditional grants with distinct improvements in allocative efficiency.

Unconditional transfers also need occasional review to ensure that they adequately compensate for disparities in fiscal capacities. However, this is not an easy issue with which to deal. Opinions vary about the extent of fiscal capacity deficiencies and the methods to reduce them overall and/or to reduce interjurisdictional disparities. Any formula designed to equalize fiscal capacities must take account of differences in local revenue sources and in fiscal requirements or needs. Currently, provincial-municipal grants typically account, in some way, for differences in revenue-raising capacities through unconditional grants, but rely more upon conditional funds to recognize differences in needs. However, providing additional support unconditionally when local needs are greater enhances local autonomy and responsibility and is preferable when there exists little or no cause for interfering with local priorities. As certain Australian evidence demonstrates, unconditional assistance to local governments can be structured to incorporate need factors.[51]

Whether or not transfer programs are changed, more consultation of provincial governments with local governments about grant programs and policies (and other concerns) could improve the satisfaction and understanding on both sides. Also, efforts to provide greater continuity and stability to grants, regardless of type, would be much appreciated by local authorities whose budgets and planning are often put in turmoil by unexpected revisions.

Revenue sharing is a way in which provincial governments can provide local governments with access to the so-called growth taxes. Whether such changes actually augment local revenue sources depends upon other simultaneous revisions in the provincial-municipal grant structure. In Canada, the introduction of revenue sharing has served more as an occasion to reform the unconditional grant program, and to earmark funds to support it, than as a method of supplementing municipal revenues.

The central issue under revenue-sharing programs is often the rate of sharing. Recipients, who are not responsible for raising the funds and may not be closely linked with the extra taxes, have the incentive to pressure for a larger share. The success of such efforts serves to reduce the tax-benefit linkage at the local level. As long as revenue sharing does not reduce the dependence on conditional grants, it does little to decentralize decision making in the public sector.[52]

An indirect form of revenue sharing is possible through the use of property tax deductibility from personal income taxes or through property tax credits against income taxes. Given the lack of concern expressed by the provinces when a mortgage interest property tax deductibility proposal was recently part of the platform of the Progressive Conservative party, such an approach may offer an uncontentious way for the federal government to assist local government. Despite this possibility, programs of this sort have little to recommend them. Property tax deductibility, along with mortgage interest deductibility, is one of the features of the United States tax system which is regularly criticized and widely recommended for removal (Break, 1980; Break and Pechman, 1975). Residential property tax deductibility is an inequitable revenue-sharing program in terms of its allocation among individuals and jurisdictions.[53] The relief provided by tax deductibility varies with the taxpayer's marginal tax rate and so increases with income. Consequently, the deduction benefits the rich more than the poor. High-income municipalities also benefit more than low-income municipalities because individuals face higher tax rates, a larger proportion of persons pay income taxes, and/or a larger portion are owner occupants rather than renters and so have property taxes to deduct. The inequality can be further aggravated when high income jurisdictions levy higher property taxes in order to finance a better quality or greater quantity of public services.

A property tax credit has some advantages over the deduction alternative. A simple tax credit, particularly if refundable, provides the same absolute relief to all income tax filers regardless of income level and extends property tax relief to renters. While the credit can substantially reduce the regressiveness of the property tax, it appears that few of the non-income taxpayers eligible for the tax credit actually apply. This latter fact is one of the reasons that Bird and Slack have concluded from their assessment of the Ontario program that it has not been ". . . terribly successful or terribly needed" (Bird and Slack, 1978, p. 120).

Property tax credits and deductions reduce the net burden of the local property tax. One argument in support of these programs is that such relief enables local governments to utilize the property tax more fully. Evidence from the United States (Inman, 1978, pp. 289–90) suggests that the response to the reduction in the tax price is to raise local property taxes so much that the property tax burden (after relief) actually increases. Hence, it could well be that efforts to reduce the local tax burden this way would have a perverse result.

Some arguments can be made that, for stabilization reasons, the federal government could make countercyclical transfers to municipalities to stimulate economic activity at a local level. Evidence that provincial government policies (impacting on localities) have been contrary to federal efforts to stabilize the economy is needed before lending support to such a federal program. Even if a problem, a suitable program would require timely introduction and termination of programs, a recognition of differences in the excess capacity in local economies, and a political will to withdraw programs or refuse funds to certain areas. A careful assessment would be required to determine the feasibility and merits of a major program of this kind. At the same time, past Canadian experience in intergovernmental relations and experience in the United States with countercyclical grants suggest caution.[54]

Modifying Intergovernmental Relations

If local governments were to have their way, they would likely ask for full constitutional standing as equal partners in Confederation. Ideally, this recognition would provide the legislative and fiscal autonomy which local governments require to meet the demands for local goods and services. But, if this were done, how successful would it be? Federal-provincial relations are defined by the Constitution, yet the extent of federal-provincial discord is well known. Provincial governments criticize the intrusion which they see the federal transfers or expenditure powers making into their areas of responsibility. In some ways, the delineation of authority provided by the Constitution has impeded a rational reallocation of responsibilities over time as conditions changed from those of the nineteenth century. Might a constitutional standing for local government impose another element of inflexibility while protecting and enhancing local government?

If local governments had achieved constitutional recognition at Confederation, how would Canadian intergovernmental relations appear today? Would the results be better than the current system? The answer, of course, is speculative in that it depends upon the powers and responsibilities assigned to local governments and at which government's expense. It is not difficult to conceive, however, of versions in which provincial powers were circumscribed, with a larger local sector having much more federal-local interaction; or, alternatively, of one in which the overall pat-

tern of functions would be not much different from that of today, but with local government maintaining a broader revenue base, despite having forgone some expenditure responsibilities. Essentially, the forces of economic development may determine, for many functions, the logical assignment of responsibilities with institutions bending, sometimes reluctantly, to accommodate the transition. Thus, it seems reasonable to expect that, even with local constitutional recognition, local government responsibilities may not have been unlike those which have evolved, or, even if they were greater, not without substantial federal-provincial intervention to improve the allocation of society's resources. An element of local government's concern with intergovernmental relations would continue even with constitutional standing, because it would remain "low man on the totem pole" with respect to the federal and provincial governments' expenditure powers — sometimes justifiably so, if local decisions have third-party effects. Local government would, however, likely have maintained a broader and more adequate revenue base, and so greater autonomy, in that sense.

Providing local government with an appropriate place in the Constitution offers several advantages to local government and might enhance the political decision-making structure of the country. Intergovernmental affairs might be improved with local government representation. This standing, as separate units, would presumably provide local governments with the power to design and modify their own institutional structure and arrangements. If the local revenue base were redefined and altered, local government would be better able to meet the responsibilities allocated to it and to link the costs to the benefits of local services. Obviously, constitutional recognition could take a variety of forms. The choice of the most suitable alternative is beyond the scope of this paper, but the issue deserves further consideration.

While constitutional recognition seems unlikely at present, an increase in the fiscal autonomy of local governments could be achieved through alternative methods. For instance, reluctance on the part of provincial governments to enhance local autonomy might be compensated by greater federal involvement. Although now waning, federal government transfers to localities expanded dramatically in the United States in the late 1960s and 1970s; a similar role for the federal government in Canada might also be a possibility. If it were, expanding unconditional grants are to be preferred to expanding conditional grants. An alternative, but one to be guarded against for equity reasons, is to introduce the deductibility from income tax of the local property tax. Federal-local revenue sharing, however, may be feasible. Clearly it is attractive at the local level, although the provinces would view it as an encroachment into federal-provincial territory. Alternatively, the federal government could offer to administer a local income tax. However, even with equalization, the localities are likely to be less enthusiastic about this alternative because of the local account-

ability it would impose. Also, the provincial political costs and the commitment of federal funds (at least currently) are almost certain to negate these as viable options.

While any of these schemes for local fiscal autonomy could be accomplished at the provincial level, it may be advisable also to consider federal involvement. Generally, the provinces may not regard it in their interests to provide fiscal autonomy to local governments. Even if they did, advocating an expansion of provincial-local revenue or tax base sharing in the current fiscal climate is unlikely to receive a favourable reception. In fact, provincial governments are more likely to consider both a reduction in their commitments to local government and a shift of some service responsibilities to the local level. Unfortunately, if such a transfer were to occur, it is not likely to coincide with a corresponding expansion in unconditional transfers or, better from the fiscal responsibility perspective, an expanded local tax base.

Finally, intergovernmental fiscal relations at the local level are too limited and lopsided. Municipalities interact only with the provinces, and then they are largely dictated to by the provinces. Provincial-municipal relations would benefit from a more cooperative and consultative arrangement. Though much less important at this time, improved federal-local communication would help. A federal Department of Local Affairs might close the information gap, but any streamlining would require a cooperative spirit by all three levels of government. Past experience with federal-local interaction is not encouraging, particularly because the provincial governments have jealously guarded their authority over local government.

Summary and Conclusions

The role of local governments in Canadian federalism has changed significantly during the twentieth century. Compared with provincial governments, the local sector has undergone a decline in relative importance. This reduction is attributed to a major expansion in the services supplied by the provincial governments, many of which had been primarily local responsibilities. At the same time, through a substantial increase in the use of intergovernmental transfers (especially conditional grants), the provinces have come to play a much greater role in the funding of those services which are still local responsibilities. Responsibility transfers and expanded grants have eased the local fiscal burden and have reduced relatively the reliance on property taxes as a means of funding local services.

Throughout this period of change, local governments have continued to be closely controlled by provincial governments. Provincial controls take the form of regulations, expenditure requirements, and conditional grants. In many ways, the controls have created an environment which has encouraged municipalities to protest about their fiscal difficulties and

lack of autonomy. In fact, these problems prompted many municipalities in 1983–84 to appear before the Royal Commission on the Economic Union and Development Prospects for Canada, requesting changes and assistance in facing local problems. Whether these problems are sufficient to warrant federal intervention is a point where differences of opinion may surface. However, there appears to be no real basis for accepting federal intervention. In fact, a few changes, although these may be significant, in the current expenditure-finance relationship between provincial and local governments could eliminate the source of most concerns. Not only would these benefit local governments but they could also benefit provincial governments.

The kinds of changes we recommend are intended not only to make local governments more responsible for providing local services but also for financing those services so as to achieve a closer link between the benefits and costs of local government. To do so would provide more autonomy for local government. Most of these recommendations deal with aspects of local government finance — reform of the property tax, grant reform, and the possible extension of the local tax base — but responsibility assignment and intergovernmental relationships are also involved.

The property tax is suited to local government and municipal government in particular. The current system, however, discriminates against non-residential and favours residential property, causing distortions and inequities. This discrimination should be corrected and reform could be accomplished in large part by structuring the local property tax so that it more closely approximates a user charge designed to cover the cost of local services to each kind of property.

The conditional grant system is unnecessarily large and overly complex. It needs careful review, especially as it relates to municipal government, with the intention of replacing many conditional transfers with unconditional grants. Too many conditional grants exist apparently to augment local fiscal capacity, a purpose for which they are poorly suited.

Rather than grants to supplement insufficient fiscal capacity, consideration should be given to expanding the local tax base with a local income tax. This tax could easily be "piggybacked" on the provincial income tax, with rates set by the individual municipalities. With equalization, inadequate fiscal capacity would not be a problem. At the same time, local decision makers remain highly accountable (because they set the rates) to local taxpayers, unlike when the deficiency is made up with grants. This change could easily be implemented for large municipalities; if the scheme were felt to be too complex when including the many smaller communities, they could be accommodated together through revenue or tax base sharing as exists in some provinces.

Access to a local income tax could afford some potential for expanded local responsibility. The provincial funding of schooling has expanded to the point where several provinces have assumed full financial responsibility

for schools, primarily because the local property tax was felt to be an inappropriate source of revenue for this service. A local income tax with equalization would permit a much expanded local financial and decision-making role. In the absence of an extension of the tax base in this way, provincial responsibilities may continue and even expand. However, fiscal pressures on the provinces and the reduced fiscal burdens on local governments resulting from demographic trends might generate the opposite; that is, a shift of some responsibility to the local level without a compensating shift in the fiscal resources.

These changes are necessary if local governments are to have more autonomy and are to supply local services more efficiently and in an accountable manner. Improved provincial-local consultation would serve to assist these developments and improve intergovernmental relations at the local level.

Appendix Tables

TABLE 6-A1 Per Capita Net Expenditure Levels by Function, Provincial and Local, Selected Years, 1913–80[a]

Function	1913				1933				1953				1980			
	Provincial Per Capita	% of Total	Local Per Capita	% of Total	Provincial Per Capita	% of Total	Local Per Capita	% of Total	Provincial Per Capita	% of Total	Local Per Capita	% of Total	Provincial Per Capita	% of Total	Local Per Capita	% of Total
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%
Health	—[a]	—[a]	—[a]	—[a]	1.73	10.0	1.36	6.6	14	20.9	4	9.3	612	36.7	15	2.8
Social Welfare	0.60	11.5	1.13	11.2	4.18	24.1	3.82	18.6	7	10.4	2	4.7	317	19.0	17	3.2
Environment	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	4	9.3	33	2.0	85	16.0
Transportation and Communication	1.21	23.1	2.04	20.2	3.09	17.8	2.45	11.9	24	35.8	15	34.9	179	10.7	103	19.4
General	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	4	6.0	5	11.6	158	9.5	59	11.1
Protection	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	5	7.5	7	16.3	83	5.0	86	16.2
Recreation and Culture	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	2	4.7	36	2.2	65	12.2
Debt	0.45	8.6	2.74	27.2	4.54	26.2	5.45	26.5	4	6.0	3	7.0	201	12.1	68	12.8
Other	2.98	56.9	4.18	41.4	3.82	22.0	7.45	36.3	9	13.4	1	2.3	49	2.9	33	6.2
Total Excluding Education	5.24	100.0	10.90	100.0	17.36	100.0	20.54	100.0	67	100.0	43	100.0	1668	100.0	531	100.0
Education	1.33	20.2	3.84	27.6	2.54	12.8	7.00	25.4	16	19.3	25	36.8	531	24.8	165	23.7
Total Including Education	6.57	—	13.93	—	19.90	—	27.54	—	83	—	68	—	2219	—	696	—

Source: Calculated from data in F.H. Leacy, ed., *Historical Statistics of Canada*, 2d ed. (Ottawa: Statistics Canada, 1982); *Provincial Government Finance: Revenue and Expenditure, 1980* (Ottawa: Statistics Canada, 1980); and *Local Government Finance, 1980* (Ottawa: Statistics Canada, 1980).

Note: Net expenditures exclude those made from conditional grants received from other governments. Net general expenditures of provincial governments exclude unconditional grants to local governments.

a. Included in Other.

TABLE 6-A2 Ratio of Local Government to Provincial Government Net Expenditures by Major Function, Selected Years, 1913–80

Function	1913	1926	1933	1947	1953	1961	1971	1980
General Government	—[a]	—[a]	—[a]	—[a]	1.4	1.1	0.4	0.4
Protection	—[a]	—[a]	—[a]	—[a]	1.4	1.8	1.1	1.0
Education	2.9	3.1	2.8	1.1	1.6	1.0	0.4	0.3
Health	—[a]	—[a]	0.8	0.3	0.2	0.1	0.0	0.0
Social Welfare	1.9	1.1	0.9	0.9	0.3	0.2	0.1	0.1
Transportation and Communication	1.7	2.1	0.8	0.3	0.5	0.5	0.5	0.6
Recreation and Culture	—[a]	—[a]	—[a]	—[a]	—[a]	3.3	2.1	1.8
Environment	—[a]	—[a]	—[a]	—[a]	—[a]	—[a]	10.3	2.6
Debt	6.1	1.8	1.2	0.6	0.8	2.0	0.7	0.3
Net General Expenditure	2.1	1.9	1.4	0.7	0.8	0.7	0.4	0.3

Source: See Table 6-A1.

a. Included in "Other" category, which is not reported because it includes many small items.

TABLE 6-A3 Per Capita Conditional Grants to Local Governments by Function and Donor Government and as a Percentage of Total Local Expenditures, Selected Years, 1913–80

Function	1913			1930			1953			1980		
	Federal	Provincial	Conditional Grant as a Percentage of Gross Local Expenditure	Federal	Provincial	Conditional Grant as a Percentage of Gross Local Expenditure	Federal	Provincial	Conditional Grant as a Percentage of Gross Local Expenditure	Federal	Provincial	Conditional Grant as a Percentage of Gross Local Expenditure
	$	$	%	$	$	%	$	$	%	$	$	%
Health	—	—	—	—	—	—	0.01	0.21	5.5	—	43.97	74.5
Social Welfare	—	—	—	—	—	—	0.03	0.69	26.5	—	18.59	52.2
Environment	—	—	—	—	—	—	—	—	—	1.72	12.62	14.4
Transportation and Communication	—	—	—	—	—	—	0.03	2.44	14.0	1.22	33.10	25.0
General	—	—	—	—	—	—	—	—	—	0.13	2.10	3.6
Protection	—	—	—	—	—	—	—	0.39	5.3	0.07	2.04	2.4
Recreation and Outline	—	—	—	—	—	—	—	0.03	1.5	1.15	7.88	12.2
Debt	—	—	—	—	—	—	—	—	—	—	15.20	18.3
Other	—	—	—	—	—	—	—	0.20	16.7	3.47	10.16	29.2
Total Excluding Education	—	—	—	—	—	—	0.07	3.86	8.3	7.76	145.66	23.0
Education	—	—	—	—	—	—	—	10.19	29.0	—	317.43	65.8
Total Including Education	—	0.58	4.0	—	1.82	6.2	0.07	14.05	17.1	7.76	463.09	40.4

Source: See Table 6-A1.

Note: Conditional grants are not broken down by function for 1913 and 1930.

TABLE 6-A4 Per Capita Revenue Levels by Source, Selected Years, 1913–80

Source	1913		1930		1953		1980	
	$	%	$	%	$	%	$	%
Taxes								
Real Property	12.53	79.2	24.78	76.5	44.11	63.6	355.50	31.4
Business	[a]	[a]	[a]	[a]	[a]	[a]	39.20	3.5
Other	0.91	5.7	2.47	7.6	3.58	5.2	1.80	0.2
Total Taxes	13.44	84.9	27.25	84.2	47.69	68.8	396.50	35.1
Privileges, Licences								
Permits	0.69	4.4	1.09	3.4	1.06	1.5	6.96	0.6
Sales	—	—	—	—	—	—	108.39	9.6
Fines and Penalties	—	—	—	—	—	—	8.93	0.8
Other	1.12	7.1	2.22	6.9	4.31	6.2	90.40	8.0
Total Own-Source Revenue	15.25	96.3	30.56	94.4	53.06	76.5	611.18	53.9
Unconditional Grants	—	—	—	—	1.99	2.9	52.33	4.5
Conditional Grants	0.58	3.7	1.82	5.6	14.11	20.3	470.85	41.5
Total Revenue	15.83	100.0	32.83	100.0	69.16	100.0	1133.36	100.0

Source: See Table 6-A1.

a. Included in property tax where it exists.

TABLE 6-A5 Distribution of Local Revenue Sources by Province, 1980

	Own-Source Revenue						Grants					Total Revenue Per Capita
	Property and Related Taxes[a]		Sales of Goods and Services	Other	Total		Specific purpose		General Purpose Per Capita	Total		
	Education	Other Municipal Services			Percent	Per Capita	Education	Other Municipal Services		Percent	Per Capita	
	%	%	%	%	%	$	%	%	$	%	$	$
Newfoundland	8.4	34.7	11.2	7.8	62.1	171	0	25.1	12.8	37.9	104	275
Prince Edward Island	0.2	9.8	5.7	2.9	18.6	109	71.2	7.2	3.0	81.4	477	586
Nova Scotia	22.8	2.1	7.7	3.8	36.4	345	27.6	22.3	13.8	63.6	604	950
New Brunswick	0	35.8	15.0	3.4	54.2	151	0	15.0	30.8	45.8	128	279
Quebec	2.4	27.2	6.3	5.3	41.2	481	46.2	7.5	5.1	58.8	686	1167
Ontario	18.8	21.2	9.3	5.3	54.6	649	22.8	15.3	7.4	45.4	540	1189
Manitoba	19.4	22.5	7.5	7.8	57.2	626	22.5	12.1	8.1	42.8	467	1093
Saskatchewan	17.6	17.3	9.3	7.2	51.4	574	24.5	17.2	6.9	48.6	542	1116
Alberta	13.6	11.5	15.0	13.0	53.1	853	18.5	23.0	5.4	46.9	753	1607
British Columbia	29.8	18.3	13.4	7.9	69.4	702	16.0	7.8	6.8	30.6	310	1013
Canada	14.6	20.8	9.6	6.6	51.6	584	28.0	13.5	6.9	48.4	549	1133

Source: Local Government Finance, Actual, 1980 (Ottawa: Statistics Canada).

a. Since data on property taxes for education are not separated from those for other municipal services, the figures here are estimated in the following manner. Conditional grants for education are deducted from total expenditures on education, leaving the residual which is financed by property taxes. Property tax totals for education are subtracted from *total* property taxes to obtain the amount for funding other municipal services.

Notes

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The authors thank two anonymous reviewers for their extensive and valuable comments. The responsibility for any remaining errors or omissions is, of course, solely ours.

1. Many of the topics addressed in this paper are discussed in more detail in an extended version of the paper, "Local Government and Canadian Federalism: Review and Assessment," Research Paper 84-15 (Edmonton: University of Alberta, Department of Economics). The interested reader is also referred to Kitchen (1984) and McMillan (1981).
2. These are the terms used in the Smith report (Ontario, Committee on Taxation, 1967). For further discussion of these and other views see Cameron (1980) and Sharpe (1981).
3. The economic form of federalism is the focus of fiscal federalism. See Oates (1972, p. 17). Variations in the tax-service combinations of local governments within a region (particularly metropolitan areas) offer some choice of local public sector consumption, through mobility, to area residents. While this aspect is not dwelt upon here, Tiebout's (1956) recognition of the situation led to extensive study. Much of that work is reviewed and reflected in Gramlich and Rubinfeld (1982), Henderson (1979) and Yinger (1982).
4. Musgrave and Musgrave (1980, pp. 515–20) illustrate the achievement of optimal community size in the presence of such differing considerations.
5. When benefits are unequal yet each resident has one vote, the best solution is not necessarily to encompass all those affected in one jurisdiction, but to exclude those with small stakes in the issue (McMillan, 1976).
6. For further discussion of the use of transfers to address equalization, fiscal gap and spillover problems, see Boadway (1980).
7. Local governments need not be excluded entirely from a redistributional role. Local taxes and expenditures will typically incorporate some intentional redistribution in recognition of local needs and preferences. However, such redistributions should be of relatively minor importance, with provincial and federal governments bearing the bulk of the responsibility for income redistribution.
8. Henderson (1979) surveys this literature.
9. The constitutional position of municipalities is reviewed in Cameron (1980), Higgins (1977), McWhinney et al. (1980, 1982), Plunkett (1972), Plunkett and Betts (1978) and Siegel (1980).
10. See Appendix Table 6-A1 for details. The shift from local to provincial responsibility is detailed by function in the trends reported in Appendix Table 6-A2.
11. See, for example, Higgins (1977) and Plunkett and Betts (1978).
12. For a critical survey of this literature, see Gillespie (1971). Inman (1978) also reviews the more recent studies.
13. For further implications which the results of this article and other studies have for explaining the growth of government, see Borcherding (1977).
14. Based upon preliminary figures of expenditures in urban regions for 1978, from *Local Government Finance — Preliminary 1978, Estimates 1979* (Ottawa: Statistics Canada, Annual), with figures for the earlier period calculated from data in Canada, Royal Commission on Dominion-Provincial Relations (1940), *Book III*.
15. See Appendix Table 6-A3.
16. See Appendix Table 6-A4.
17. As a percentage of net expenditure, unconditional grants increased until 1965 but since then have shown no trend, remaining at a level of about 7 percent (7.3 percent in 1980).
18. This dramatic change is reflected in the declining ratios of local to provincial net expenditures by function reported in Appendix Table 6-A2.
19. See Appendix Table 6-A1.
20. See Appendix Table 6-A4.
21. Note that gross and net expenditure values include debt-financed outlays. Borrowed funds are not reported in revenues.

22. While it may be preferable to relate property taxes to property income, the lack of data prevents that comparison.
23. Calculated from data in *Economic Review* (Ottawa: Department of Finance, Annual).
24. Further information on revenue sources is found in Appendix Table 6-A5.
25. For details on the interprovincial variation in expenditures see Kitchen (1984, chaps. 3, 4 and 5).
26. See Kitchen (1984, chap. 6).
27. Ontario, (1977a), and Slack (1981), for example.
28. Because of the ease of interjurisdictional mobility and the restricted tax base, local governments are not well suited to effecting significant income redistribution. Also, if a locality bears the full cost of education or other service but realizes only a portion of the total benefit because the remainder spills over to residents in other jurisdictions, the providing community will supply less than the amount which society would prefer.
29. While several provinces have acted recently to better rationalize their unconditional funding, the level of unconditional support has not expanded significantly. The reluctance to extend unconditional aid often results in municipalities recognizing the reality of the situation and asking for more conditional funds while bemoaning their dependence on them. Also, while the rationalization of unconditional funding in some provinces has improved the equity of their allocation, in others there is still substantial room for improvement (McMillan and Norton, 1981; Slack, 1981). Such deficiencies have not encouraged municipalities to push for a shift to unconditional support.
30. The figures reported are one of seven projections reported by Statistics Canada, each of which is based upon specific assumptions which may or may not be realized. Projection 4 provides intermediate results.
31. See Foot (1984) for an elaboration of this topic.
32. See Mieszkowski and Stein (1983) and Foot (1984) for some discussion of demographic effects on expenditures.
33. See *Household and Family Projections, 1976–2001*, Occasional Publication 91-522, Statistics Canada (Ottawa, 1981).
34. Bahl (1981) also finds the consequences of these changes hard to predict.
35. For a discussion of tax visibility and the taxpayer's criticism of perceived tax increases, see Bird and Slack (1981).
36. For general assessments of the property tax, see Bird and Slack (1978, 1983), Boadway and Kitchen (1984), Break (1970), Kitchen (1984), Thirsk (1982), and the papers appearing in *Canadian Public Policy* 2 (Supplement 1976).
37. See Kitchen (1984, chap. 8) for an elaboration on the evidence.
38. The limited evidence which is available suggests that the non-residential sector receives only about 60 percent of the benefits of the residential sector. See Clayton (1968) and Thirsk (1982).
39. Estimates of tax exporting in selected Ontario municipalities are reported in Thirsk (1982). On the exporting of local taxes in general, see Ladd (1975).
40. See Bird (1976) for a thorough discussion of the rationale for user fees and potential application at the local level. See Bossons (1981) on the externalities aspect.
41. In practice, property tax reform is difficult both to design and implement. See, for example, Bird and Slack (1981), Bossons (1981) and McMillan (1980).
42. For a more comprehensive discussion, see Bird and Slack (1983).
43. A somewhat intermediate position is for the province, rather than the locality, to tax non-residential property to support schooling (e.g., Alberta).
44. Gillespie (1971) found that, while both local taxes and expenditure benefits are regressively distributed (diminish as a percentage of income as income increases), the lowest income groups are net contributors to the local public sector. In absolute terms, however, both taxes and imputed expenditure benefits increase with income.
45. Bird and Slack (1978) provide a critical assessment of the Ontario property tax credit. They question both the success of and need for the program.

46. See McMillan and Plain (1979) for a more complete discussion.
47. Canadian studies include Johnson (1973), Kitchen (1982), McMillan and Plain (1979) and Silver (1973). Also see Bird and Slack (1983), Boadway and Kitchen (1984) and Kitchen (1984) for discussions.
48. See for example, McMillan and Plain (1979), Ontario (1977a), Richmond (1980) and Slack (1981).
49. See Slack (1981) for a discussion of this problem in Ontario.
50. The legislation allows for the municipalities to change the rates by mutual agreement, but no change has yet occurred.
51. For a particularly good example, see the annual reports of the Victoria Grants Commission (1978–84).
52. For a review of revenue-sharing programs, see McMillan and Plain (1979, chap. 4).
53. Such property tax relief would also serve to reduce the tax burden on the residential sector, and on homeowners in particular. For a discussion, see Fulton (1982). McMillan (1979) proposes and discusses an alternative scheme.
54. For some discussion of the U.S. experience, see Bahl (1981).

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